Retail Energy Code Company Ltd
27 Old Gloucester Street
London, WC1N 3AX

Retail Energy Code Company
info@retailenergycode.co.uk
www.retailenergycode.co.uk

By email only: priceprotectionpolicy@ofgem.gov.uk

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RECCo response to: Call for input - Energy Price Cap, Enduring Unidentified Gas Allowance

We welcome the opportunity to respond to this consultation. Our non-confidential response represents the views of the Retail Energy Code Company Ltd ("RECCo") and is based on our role as operator of the Retail Energy Code ("REC"). RECCo is a not-for-profit, corporate vehicle ensuring the proper, effective, and efficient implementation and ongoing management of the REC arrangements. We seek to promote trust, innovation and competition, whilst maintaining focus on positive consumer outcomes. We are committed to ensuring that RECCo is an "*intelligent customer*", ensuring efficacy and value-for-money of the services we procure and manage on behalf of REC Parties, including those which constitute the REC Code Manager.

The REC requires RECCo to have in place a Theft Reduction Strategy, so we share a direct interest in identifying and reducing the theft-related component of Unidentified Gas ("UIG"). While the Allocation of Unidentified Gas Expert ("AUGE") 2023/24 Statement attributes about 6,823 GWh of UIG to theft at the "line-in-the-sand", our own REC Theft Estimation Methodology[1] (late-2022) assessed theft materially lower, at ~636–1,059 GWh. Because theft is inherently covert and hard to measure, headline theft estimates can mask other UIG drivers (e.g., read timeliness, AQ error and class assignment), so while we support aligning the cap to post-reconciliation costs, any uniform allowance should not normalise UIG as a business cost or dilute incentives to address these underlying causes.

We broadly support Ofgem's proposal to revise the default tariff cap so that the UIG component better reflects the actual costs suppliers face. Basing the allowance on post-reconciliation UIG, rather than initial allocation, is the right anchor: it mirrors how costs crystallise after reads arrive and aligns with recent Uniform Network Code ("UNC") modifications (e.g. to reconcile in the period consumed[2] and a shorter "*line-in-the-sand*"[3]), improving accuracy and timeliness. That said, suppliers do retain some control over their UIG exposure. Under the UNC, UIG is allocated using AUGE weighting factors and then reconciled as actual reads arrive; stronger meter-read performance speeds reconciliation and should be a key driver for moving sites from Class 4 to Class 3, where smart-enabled portfolios see less volatility. Because allocation is by the shipper-chosen product-class classification (and not of itself evidence that the read standards of that class are actually met), it is essential that meter-read performance is effectively assured. As gas smart metering grows, it is reasonable to expect most sites to migrate to Class 3 over time—provided read performance is maintained.

A uniform allowance in the cap inevitably dampens incentives: it cushions portfolio differences and can reduce the marginal gain from investing in improving read performance, Annual Quantity ("AQ") quality and theft reduction. We therefore caution against setting a high, fixed allowance, particularly if it embeds a fixed theft as a percentage of throughput assumption; this risks over-compensating suppliers, socialising more cost, and weakening incentives to tackle causal drivers of UIG.

[1] "Theft Estimation Methodology", RECCo, December 2022
[2] UNC862: "Amendments to the current Unidentified Gas Reconciliation Period arrangements"
[3] UNC896: "Reducing the current Code Cut-Off Date (Line in the Sand) from 3 to 4 years to 2 to 3 years"

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To preserve incentives while improving cost reflectivity, we support: (i) anchoring the allowance to post-reconciliation UIG (reflecting the Line-in-the-sand), (ii) modelled, back-tested methods with out-of-sample checks, (iii) rolling or trigger-based updates rather than fixed factors, with downward-only adjustments where performance improves, and (iv) robust assurance of meter-read performance (linking class eligibility to delivered reads). This could be underpinned by transparent publication of comparative performance (reads, AQ quality, theft outcomes) that would inform any revision to the UIG allowance.

As supplier-specific cost setting is out of scope for the default tariff cap, Ofgem could adopt a glide path that tapers the UIG allowance over time, combined with a symmetric risk-share (rewards and under-performance adjustments) calibrated to post-reconciliation UIG. This would preserve competitive discipline by ensuring suppliers with stronger read delivery and higher proportions of Class 3 sites—who therefore face lower UIG allocations under UNC—retain headroom to pass through lower prices or improve margins, while avoiding over-compensation.

We consider that there is currently a structural issue which hampers the efficacy of read performance assurance in gas, insofar as Gas Suppliers are not themselves party to or bound by the requirements of the UNC. We have discussed this issue briefly at the REC Performance Assurance Board, which includes a representative of the UNC Performance Assurance Committee along with those of other code bodies and we would welcome the opportunity to collaborate more closely on addressing the meter read performance which is a common dependency of the arrangements governed by both codes. We would also welcome closer collaboration between RECCo and the AUGE on the future production of estimates of theft of gas.

We are happy to discuss any of the points raised in this response.

Yours sincerely,

Jon Dixon
Director, Strategy and Development

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Appendix: RECCo response to consultation questions

Q a) Do you have any views on data sources we should use to set an enduring allowance on UIG?

The proposed data sources are reasonable but not purpose-built; although the underlying data may be sound, repurposing them risks bias arising from legacy definitions, mappings, and categorisation. We therefore support the suggestion that Xoserve—and would also suggest where appropriate, the AUGE—undertake bespoke analysis to produce fit-for-purpose extracts and checks, supported by clear data dictionaries and sensitivity testing.

Q b) If retaining the interim approach as the enduring approach, what are your views on keeping fixed the weighting factors to split between domestic and non-domestic based on the 2025/26 AUGE report? Are there alternative approaches we could use to retain the same data source but apply a split?

This appears to be an area that should be determined by evidence rather than preference – i.e. Ofgem could model the options (e.g., fixing 2025/26 AUGE weighting factors; using a rolling average of AUGE factors; or trigger-based updates when domestic/non-domestic shares move beyond a tolerance) and select the approach that is least prone to systematic under- or over-recovery.

The decision should be based on back-casting (e.g., 2–4 years), sensitivity testing (different UIG and demand scenarios), and out-of-sample validation to quantify bias and volatility. If the fixed 2025/26 factors perform as well as or better than alternatives on bias, stability, and simplicity that would support fixing them; if not, adopt the best-performing data-driven variant (e.g., rolling or trigger-based), using the same AUGE data source and publishing clear update rules.

Q c) Do you have any views on the methodology we should use to set an enduring allowance on UIG? This could include:
i. number of years of data the calculation should be based on (e.g. last two gas years);
ii. EUCs and Profile Classes to calculate UIG on, including any evidence on which EUCs and Profile Classes price cap customers sit within;
iii. frequency of updates.

The volume of UIG is by its nature volatile, and as with many things that rely on the collection of historic data, past performance is not necessarily indicative of future results. We agree that the use of a two-year (minimum) rolling average would therefore smooth the results and mitigate any windfall effect in the allowance.

As previously mentioned, correlations can be imprecise where data sets are used for purposes for which they were not originally. This is the case with the gas End User Category ("EUC") bands, which were intended to reflect consumption rather than whether that consumption is for domestic or non-domestic use. Traditionally, EUC1 (Smaller Supply Points) equating to an AQ of <73,200 kWh was used as a proxy for domestic households. However, given that both EUC1 and EUC2 (73,201 – 293,000 kWh) are now split to reflect the presence of both domestic and non-domestic supply points and pre-payment and credit meters, it seems appropriate to include both of those EUC bands in the calculation of UIG for tariff cap purposes.

We also agree that the methodology should continue to focus on settlement product classes 3 and 4. While we note from the consultation that only 16% of domestic consumers are assigned to Class 3, this is still a sizeable cohort. Further, the purpose of introducing the weighted allocation based on settlement class was at least in part to incentive shippers to migrate consumers onto the more frequently read products as and when smart metering allowed, as that of itself would reduce the amount of temporary UIG.

We agree that an annual update would be appropriate, as UIG is not necessarily seasonal and the primary source of data is likely to remain the AUGE data and/or the annually revised sources of data relied on by the AUGE.