

Rachel Fletcher
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Ofgem
9 Millbank,
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30th September 2010

ICoSS Response to Open Letter consultation on Gas Distribution Price Control 2 (GPD CR 2)

Dear Rachel,

The I&C Shippers and Suppliers (ICoSS) group represents all the major non-domestic Industrial and Commercial suppliers in the GB gas market, supplying over 60% of the gas needs of the I&C Sector. In addition to comments made by our members individually, ICoSS collectively wishes to make the following points with regard to the treatment of Unidentified Gas and the transporters agent in this price control. We have limited our comments to those areas that directly affect the retail gas market.

Treatment of Unidentified Gas & Shrinkage

A key issue for the current gas market is the treatment of Unidentified Gas (the term given to system losses that occur downstream, i.e gas theft downstream of the meter, open bypasses, unregistered sites, etc) and Shrinkage (defined as those system losses that occur upstream of the meter, so gas theft directly from the network, pipe leakage, etc).

Until recently, the market arrangements meant that all the Unidentified Gas attributable to all types of consumers was allocated to Non-Daily-Metered Smaller Supply Points (NDM SSPs), i.e the customers with an annual demand of less than <73,200 kWh. How to apportion Unidentified Gas to the LSP NDM Sector has been one of much debate within the gas industry and has been the subject of numerous UNC modifications.

The solution approved by Ofgem, Modification 0229, appoints an independent expert to determine annually the Unidentified Gas that is attributable from the NDM LSP sector. The 0229 process replicates the Shrinkage process, which is where the Gas Transporters undertake analysis of their network and then determine a fixed annual value. Modification 0229 is the best solution that could be implemented in the UNC as it currently stands. It is ICoSS's view that when looked at holistically, the Modification 0229 process is not the most efficient solution possible it means that two parallel processes (Unidentified Gas and Shrinkage) determine system losses..

This was recognized by the Industry that combining the processes would be a better solution and to this end Modification 0232 was raised. This modification proposed that Shrinkage was widened to include Unidentified Gas. The idea was considered to have merit, but it was recognised that it would require changes to the price control to work and so Modification 0229 was pursued instead. ICoSS believes there is a unique opportunity to improve the current processes that handle Unidentified Gas and so we propose that the scope of Shrinkage is widened to include all gas losses (such as theft, unregistered sites, open By-pass valves, etc). The Gas Transporters would then determine the total

Shrinkage across the DNs. The cost of these losses would be met as now (through Distribution Network Transportation Charges) and the Gas Transporters would still be subject to an incentive to reduce these losses.

Harmonising the treatment of gas losses greatly enhances the efficiency of the process. Instead of two parallel processes, a single regime would be operated, halving the cost to the industry. Including the cost of gas losses in Transportation charges also simplifies the current processes for accounting for the gas, reducing the administrative burden on Shippers, reducing costs for consumers.

Expanding Shrinkage to include Unidentified Gas also addresses a concern with the Modification 0229 regime. The modification places no explicit incentives on Shippers to reduce the materiality of Unidentified Gas, something that Ofgem recognised in its impact assessment on the area. Including Unidentified Gas in Shrinkage makes it subject to an incentive regime. If incentivised we would expect that the Gas Transporters would place obligations, via the UNC, on Shippers to address its causes. This is likely to ensure a steady reduction in the causes of Unidentified Gas.

Lastly, harmonizing gas loss treatment ensures a robust solution that is capable of handling the evolution of the gas market throughout the duration of GPDCR2, which will be in effect until April 2021. The rollout of Smart Metering by 2020 will mean that each site in the country will have access to daily read information. Project Nexus will provide the capacity for each site to be settled on actual (as opposed to estimated) consumption data, but it is expected that a residual amount of Unidentified Gas would remain.

This industry evolution will effectively move Shrinkage determination from an estimation process to a process where metering data determines the true materiality of system losses. Combining all system losses into the current Shrinkage regime would ensure that significant changes to the Unidentified Gas process would not be needed mid-price control to recognise this development.

Unifying the Unidentified Gas and Shrinkage processes can bring significant benefits and taking this opportunity now will enhance the system losses regime, the efficiency of the market will improve and the materiality of Unidentified Gas will decrease.

Xoserve

The other area we wish to comment on is the proposal to re-examine the arrangements for the transporter's agent, xoserve. We completely agree with Ofgem that, since the implementation of the User Pays arrangements in the last price control, the level of service experienced by its customers (Shippers) has not improved. In fact, we would go further in stating that the level of service has markedly deteriorated since the introduction of the User Pays arrangements.

It has been our experience that xoserve has not become a customer-facing organization. User Pays has not resulted in any increase in transparency, or a willingness to meet Shipper requirements with innovative or cost-effective solutions. There is instead a stubborn refusal to engage, and all system changes are still referred to the Gas Transporters, even if they are not impacted in any way by them. This lack of a commercial focus has caused significant problems in Shipper-led changes to the UNC, such as the creation of a DM Elective process (Modification 0224) and use of Smart Metering for SSPs (Modification 0270).



Shippers have a clear incentive to ensure that the system funding and governance processes are fit for purpose. To that end, one of our members Gazprom Marketing and Trading – Retail Ltd has raised a review proposal (0334) that will examine the funding and system governance arrangements since the DN Sales. We intend that this modification will provide an opportunity for the industry to identify areas of good and bad practice and so help inform the GDPCR2 process.

Please contact me if you require any further comments.

Yours Faithfully,

A handwritten signature in black ink, appearing to read 'G. Evans'.

Gareth Evans
Chair, ICoSS Group