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By email: GDPCR2@ofgem.gov.uk

Dear Bob

**SUBJECT: Response to Open letter consultation on Gas Distribution Price Control 2 (GDPCR 2)**

Total Gas & Power Ltd welcomes the opportunity to comment on the proposed way forward on the Gas Distribution Price Control Review 2 (GDPCR2). We have limited our comments to those areas which we believe are of particular importance with regards to the operation of the gas market, in particular those which impact upon Shippers and consumers.

**Unidentified Gas & Shrinkage**

The current market arrangements for the GB gas market works on the principle of daily balancing. Only the total amount of gas consumed by GB as a whole along with the consumption of Daily Metered (DM) sites is known with any degree of certainty. Gas consumption for the majority of sites is estimated through a combination of algorithms and site categorization, based on historical consumption patterns.

The determination of gas consumption for any given day for Non-daily Metered (NDM) sites works on the principle that once DM and estimated Transporter losses (Shrinkage) are subtracted from total GB consumption, whatever remains is consumed by the Large Supply Point (LSP) and Small Supply Point (SSP) NDM customers. LSP consumption is initially estimated via behaviour modelling. When a meter reading for that site is obtained, the estimated consumption is corrected with any variation between estimated and actual gas demand being credited/debited to the SSP market. This correction volume is termed RbD volume. Until recently all gas that was not attributed to the DM, Shrinkage or LSP sectors would be allocated to the SSP sector via this mechanism. This, until recently, included Unidentified Gas (as the downstream losses from theft, etc are termed) that should be attributable to the LSP NDM sector.

How to attribute 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 implemented solution, Modification 0229, appoints an independent expert to determine annually the value of Unidentified Gas that originates from the LSP sector. The process that was implemented mirrors the current Shrinkage process, which is where the Transporters determine a fixed annual value for Shrinkage, and then procure the gas to cover it. Though the Modification 0229 solution is the optimum one that could be accommodated within the UNC framework, it has resulted in two parallel processes whereby two independent valuations of losses are undertaken by two separate organisations for two separate, but related, sources. This is inefficient and results in additional costs being ultimately incurred

by consumers. There seems to be significant benefit in harmonising the treatment of losses across the Gas Networks.

As part of the work on resolving the LSP Unidentified Gas issue, Total Gas & Power Ltd proposed Modification 0232 in October 2008. In this modification we proposed that the scope of Shrinkage was widened to include Unidentified Gas that traditionally been allocated to the SSP market. Though the idea was considered to have merit, it was recognised that for Modification 0232 to work the current price control would need to be reopened, which was seen to require a disproportionate amount of work compared to the materiality of the issue.

Total Gas & Power Ltd believe that, as part of GDPCR2, the opportunity should be taken to re-examine the treatment of system losses, with a view to optimising the current process. We propose the same solution that was originally postulated in Modification 0232, namely that the scope of Shrinkage is widened to include all Unidentified Gas that is attributable to downstream sources (such as theft, unregistered sites, open By-pass valves, etc). The Transporters would then use the processes they currently undertake (i.e. estimation through analysis of system data) to determine the total Shrinkage across the DNs. The cost of this enlarged Shrinkage would be met as now; through Distribution Network Transportation Charges.

This solution confers several benefits to the Gas Industry. Firstly, as has been evidenced by the numerous modifications attempting to apportion downstream Unidentified Gas between NDM sectors, the final allocation will always be controversial and subject to challenge by Shippers. Harmonising losses determination into the current Shrinkage process (overseen by the Transporters) ensures an even distribution of cost across the whole industry, removing any concerns over bias.

Secondly it greatly simplifies the process and enhances its efficiency. Instead of two parallel frameworks (the current Shrinkage process and the similar Modification 0229 process) being operated with all the duplicated costs that entails, a single regime utilising a current framework would be used. It also simplifies the current accounting process, reducing the administrative costs on Shippers, and reducing costs for consumers.

Thirdly, placing Unidentified Gas within the Shrinkage regime means it will become subject to the incentives currently placed upon Gas Transporter to reduce Shrinkage losses. The Modification 0229 regime places no explicit incentives on Shippers to reduce its materiality, something that Ofgem recognised in its impact assessment on the treatment of Unidentified Gas. If Gas Transporters are incentivised to reduce the amount of Unidentified Gas 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.

Finally, it ensures a robust solution that is capable of handling the evolution of the gas market through the duration of GDPCR2, expected to run 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, and Project Nexus will provide the capacity for each site to be settled on actual (as opposed to estimated) consumption data. Despite each site being settled on measured consumption, it is inevitable that this will result in a residual amount of Unidentified Gas.

A solution that has been identified is to allocate that gas to the Transporters, who will then procure the gas (or possibly utilising line pack) and recover the costs via transportation

charges. This solution is effectively moving the determination of Shrinkage 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 is the necessary starting point for this solution and would ensure that significant changes to the Unidentified Gas process would not be needed mid-price control

Overall, we have identified significant benefits to the gas market for unifying the Unidentified Gas and Shrinkage processes. We believe that if this opportunity is taken now to enhance the system losses regime, the efficiency of the market will improve, the materiality of Unidentified Gas will decrease and consumers will ultimately benefit from reduced costs.

### **Xoserve**

The other area which Total Gas & Power Ltd wishes to comment on is the proposal to re-examine the arrangements for the transporters' 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 organisation. 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 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).

We therefore support Ofgem's proposal to re-examine xoserve's role, in particular the oversight of its activities by its Users as well as its funding arrangements.

Yours sincerely

Richard Dutton  
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