

Gas Shippers, Gas Suppliers and
other interested parties

Direct Dial: 020 7901 7034
Email: rob.church@ofgem.gov.uk

Date: 30 May 2014

Dear Colleague

Annual Quantity (AQ) Review: Future request for information

In July last year we wrote to gas shippers and suppliers informing them of our intention to monitor the progress of the 2013 Annual Quantity (AQ) review ("2013 AQ review"), to both gain a better understanding of the underlying issues and to the extent we are able, to provide a *health check* on the 2013 AQ review as a whole.

Following our analysis, we now have an improved understanding of some of the underlying issues, but we feel we need further information from industry as part of our efforts to undertake a health check on the review. The purpose of this letter is to update you on our current thinking and to give you advanced notice that we will be seeking further information on the AQ review process.

2013 AQ review

Following the 2013 AQ review and publication of the 'Mod081' reports¹, some shippers remain concerned that the AQ amendment activity of other shippers may adversely impact upon their relative position, resulting in them receiving a greater allocation of unidentified gas. These concerns focus on those instances where shippers have, as a result of the AQ amendment process, secured greater reductions on the volumes initially suggested by the Xoserve 'T04' files, than their peers.

Whilst the Mod081 reports provide a degree of transparency of what is happening during the AQ amendment process, we do not consider that shippers can use them alone to draw concrete conclusions about what is happening to the portfolios of other shippers.

In the appendix to this letter, we have set out some of the problems of relying on the Mod081 report alone in drawing conclusions. We consider that these issues may culminate in a misleading impression of the AQ reductions achieved by some shippers. We also consider that it is potentially misleading to focus on the AQ review process alone, as this is only one of the methods by which AQs may be revised. A shipper's relative performance under that review may not be reflective of the AQ movement to its portfolio as a whole.

¹ Following the implementation of UNC081: 'AQ Review Process - publication of information', Xoserve publishes a report in several parts, showing the activity of each shipper over the course of the amendment period, together with the final aggregate position for all supply points. This is available on the Xoserve extranet.

Our views

We do not consider that the Mod081 reports are sufficient to draw concrete conclusions on the operation of the 2013 AQ review. However, at the same time, we appreciate that the information we have to date may not provide sufficient assurance to those shippers who have raised concerns with its operation.

Although the discussions we held with a number of shippers following the 2013 AQ Review provided useful insights as to why their results may reasonably differ from their peers and for specific anomalies within the report, there are some areas which continue to give us cause for concern. For example, whilst there is no evidence that the meter reads are not genuine, or that the amendments made do not conform with existing UNC rules, some shippers appear to have submitted multiple amendments for the majority of their registered supply points, using meter reads that were older than those held by Xoserve. Whilst we do not consider the number of amendments to be a problem of itself, the intention of the process is to provide information that is more recent than that used by Xoserve in its calculation of provisional AQs.

Further, we consider that the greatest risk to the rigour of the process and the area with the least transparency is not the amended AQs, but the potential for a proportion of meter reads and/or amendments that would result in an upward revision to AQs to be withheld.

The revised gas allocation, reconciliation and settlement rules being proposed by Project Nexus are likely to provide the solution to many of the perceived shortcomings with the AQ review process. For instance, it would replace the annual review with near rolling (monthly) AQ revision, subject to valid meter reads having been submitted. In order to secure these and other benefits we will continue to press Xoserve and the Gas Transporters to deliver Project Nexus in a timely manner. We think it should be our priority and industry's priority to introduce these changes as soon as possible. However, whilst the individual reconciliation of all supply points following Project Nexus would negate much of shippers' risk of exposure to the unidentified gas costs caused by artificially low AQs elsewhere, it does not entirely remove this risk. However, the imminent prospect of Project Nexus implementation should not prevent proportionate measures being taken to ensure that AQs are as accurate as possible.

Following implementation of Project Nexus, the accuracy of gas settlements would still rely upon the timely and accurate submission of meter reads. Although the revised systems will provide opportunity for shippers to submit meter readings for all meters on a daily basis, the actual requirements under the UNC remain largely unchanged. For instance, shippers will be required to provide meter reads for no more than 70% of its 'Product 4'² Smaller Supply Points (SSPs) per annum. We are also concerned that notwithstanding the problems with the Mod081 report, the transparency that it does provide will be lost.

Next Steps

It is our intention to issue one or more formal Requests for Information (RFIs) over the coming months in order to examine further both the use of the AQ amendment process and the underlying reasons for failure to recalculate or reconfirm AQs year on year. As with the work undertaken to date, this further analysis should inform our understanding of what may be required of a gas performance assurance regime, as currently being developed under the UNC.

Given the potential scale of this review, we are keen to ensure that we adopt a proportionate approach for both ourselves and any party from whom we may ask information. We are therefore considering adopting a phased approach, asking all shippers only for documentation that should be readily available to them, for example their policy and methodology for selecting which AQs should be amended and in what priority.

² Project Nexus introduces a number of 'Products'. Product 4 is periodic readings to an agreed frequency.

We may seek further information, potentially including a sample or full details of the 'T04' files³, detailing the provisional AQs issued by Xoserve, in order to assess whether the subsequent amendments made to those AQs were reasonable and in conformity with UNC rules.

We will issue our initial request for high level information as part of a further open letter to be published in June. If appropriate we will ask for further detailed information in September from relevant shippers only. If you have any queries with or suggestions for this review, please contact Jon Dixon at: jonathan.dixon@ofgem.gov.uk or 020 7901 7354.

Yours sincerely,

Rob Church
Associate Partner, Smart Metering and Smarter Markets

³ The file by which XoServe provides Shippers with a provisional AQ for the supply meter points in their portfolios. It is also referred to as Xoserve notification of proposed AQs.

Appendix 1: Assessment of the 2013 Mod081 report

Whilst the Mod081 report provides a useful insight into what is happening throughout the AQ amendment process, there is a risk that it is used in a manner for which it was not intended and/or to draw incorrect conclusions. Below, we highlight some of the areas which we consider may have led to misperceptions.

a) City identities

The Mod081 reports preserve shipper anonymity by replacing shipper identities with that of cities. This can lead to incorrect conclusions being drawn when Big Six shippers in particular seek to compare their own results with those of their peers. Whilst it is simple to identify which six cities have the biggest portfolios, this does not correlate to the identity of the biggest six shippers, let alone their relative position. This is because several shippers hold multiple short-codes⁴ on the Xoserve systems as a result of previous mergers and acquisitions, etc. Each of these shipper short-codes is assigned a city identity and the AQ amendment results are published for the supply points registered against these identities.

Each shipper may, at its own discretion, utilise its short-codes for differing administrative purposes. For instance, we understand that some shippers may register all or the majority of its domestic consumers under one short-code, whereas business customers or those it has acquired through a particular campaign may be registered under another. Unless all of the city identities held by a given shipper are correctly aggregated, the Mod081 report can give a misleading impression of a shipper's use of the AQ amendment process.

b) Portfolio homogeneity

Whereas the trend in recent years has been for AQs to reduce, some shippers have observed a small increase in AQs across their portfolio. Some shippers have suggested that they would expect to see this trend reflected across the portfolios of all comparable peers, and where this has not happened, they have raised concerns about the process.

We do not consider that supply point portfolios, even across the Big Six, are necessarily homogenous. While they will all contain large numbers of similar customers, there are differences in the constitution of those individual portfolios, for instance resulting from their tariff structure and/or marketing activities. There may even be differences as a result of regional variances in weather and relative prosperity etc between supply points within the same End User Category⁵, which we expect to be borne out in the movement of AQs.

c) Duplicate reporting and early errors

In accordance with the original business rules for Mod081⁶, the reports show the number and direction of AQ amendments made by each UNC User (shipper) and in aggregate. However, it is quite common for several amendments to be made for a given supply point over the course of the review window. This can give a misleading impression of the size of energy movement resulting from the amendment activity. We note that a UNC modification proposal⁷ has been raised to address this issue and that it is currently going through the self-governance procedures, with a view to changing the approach for the reporting of the 2014 AQ Review.

The Mod081 report is released in three stages, with interim figures being released showing the position as at the end of June, and then at the end of July. The final figures giving the overall position are released after the revised figures take effect 1 October. Although the interim reports give a useful insight into the number of amendments to date, they are not a reliable indicator of the likely scale of those amendments.

⁴ The 3 alpha character code held in Xoserve systems that is a unique identifier for each registered Shipper.

⁵ As defined in the UNC – Transportation Principal Document – Section H1.2.1

⁶ See: www.gasgovernance.co.uk/sites/default/files/0081FinalModificationReportv20.pdf

⁷ UNC482: 'Proposed Changes to Mod 081 Reports to be effective from 01/7/14'