

SSE's Comments on Ofgem's Assessment of the Urgent UIG Modification Proposals

Thank you for the opportunity to comment on Ofgem's assessment of the urgent UIG modification proposals.

SSE agrees with a large amount of the Ofgem findings. We share the view that industry attention needs to be appropriately focused on addressing the systemic root causes of UIG, mitigating its impacts with the aim of reducing its volume. However, we do not agree that prior to the implementation of Project Nexus, the industry had become accustomed to a permanent unidentified gas estimate of around 1% of throughput. SSE was experiencing a difference between its sales and purchases significantly higher than 1%, in addition to our allocation of the RBD pot. We, therefore, are not overly surprised that the current levels of UIG are above this level and do not agree that permanent UIG post Nexus will get anywhere near to the 1.1% level, as stated by the AUGE, under the current arrangements.

Despite the above statement, we agree that it is premature to conclude that the current gas allocation arrangements are inherently flawed, as UIG levels are being directly impacted by other aspects of the industry arrangements that are not currently operating to a reasonable standard since the implementation of Project Nexus (as defined in UNC Modification 0432) and that the situation can be improved to a limited degree under the current limitations.

The CMA Order to increase the frequency of meter read submissions into settlement will, over time, improve the accuracy of gas settlement. However, daily demand estimation will still be heavily dependent upon the accuracy of profiles and the underlying quality of samples, which are being addressed by further modifications. Furthermore, we do not agree with the current allocation of UIG as directed by the AUGE, which largely falls heavily on domestic customers.

We would like to make the following response to Ofgem's four specific questions.

1. do you consider that we have appropriately identified and where possible quantified the impacts of the proposals;

We consider that you have quantified the impacts of Modifications 0642 and 0643. However, SSE supported the implementation of Modification 0642A. The reason for this is that the AUGE believes that the actual permanent level of UIG is at a level of 1.1%. We think that the true level sits well above this and is at a minimum level of 3%. Whilst we agree, as stated above, that things can work better, we believe that the overwhelming industry view amongst shippers is that the AUGE assumptions are incorrect. The AUGE is basing its figure of 1.1% on the premise that most UIG is due to theft, and hence is the reason why product 4 has roughly double the level of UIG that products 2 and 3 have for smaller customer categories. However, we believe that there are fundamental issues leading to the under recording of gas, such as shrinkage, other leakage and assumptions of average temperature and pressure which are all leading to the under recording of gas, and hence why we believe that even if all the settlement issues could be addressed, and if all NDM customers could be placed into product 2, permanent UIG would not get down to 1.1%.

2. do you consider that there are additional impacts that we should take into account in our decision making process;

Within the consultation Ofgem states:

“As the cause of that gas being lost to the system is, by definition unidentified, it is not possible to say with any certainty whether it has been consumed but not registered (e.g. though theft of poor data management) or lost in conveyance, through undetected and/or unreported leakage.”

It is our view that shippers can only largely affect the first of these two reasons for UIG and not the second. We firmly believe that significant gas is being lost in conveyance, which the AUGE assumes is not occurring, as the AUGE assumes that the shrinkage allocation is correct. Whilst shrinkage is a transporter obligation we strongly advocate that the shrinkage calculation and allowances should be brought under the auspices of the UNC and be calculated in a group such as DESC, in order that it can be calculated much more accurately. This group could also have a slightly wider remit than shrinkage to look at, for example, the likely inaccuracies of the temperature and pressure calculations. Both areas have a significant impact on UIG, were modelled and calculated decades ago when there was a monopoly provider of all gas services and when there were no commercial drivers or real impacts of getting this modelling wrong, and despite there having been significant changes and advances in both areas since then, the principles of these calculations are still being used within the industry to this day. Until these areas are addressed then the industry can only ever effectively address the first reason for UIG mentioned above, relating to settlement data, and hence only some of the causes.

We also believe that much more could be done to measure gas losses on the distribution network by taking readings from lower level meters on the network and reconciling these back to readings from LDZ metering to try and get an understanding of the levels of losses on the distribution network before it goes down to the customer level. This would have the effect of helping to understand the levels of losses on these parts of the gas network and determining a more accurate and true level of shrinkage.

3. do you agree that the current gas allocation arrangements should be assessed during a period in which all UNC obligations are being fully discharged and/or input processes are working as intended, before a conclusion can properly be made that further fundamental modification is appropriate;

We fully agree that the new Nexus arrangements relating to the calculation of allocations and the amount of UIG should be assessed during a proper timeframe before fundamental modification is appropriate. However, we believe that UIG is being unfairly targeted to product 4 customers as they are picking up double the level of UIG those in products 2 and 3. For the reasons mentioned above we believe that are significant losses that are being unaccounted for and so should be the subject of allocation to shippers based more on throughput. Linked into this there should be ongoing estimates of the level of UIG. The AUGE will not provide any further estimated levels of UIG for several months until the production of the first draft statement for the 2019 / 20 gas year, whilst UIG levels for the early months of Nexus, which have had a significant amount of reconciliation activity linked to them, show no signs of getting near the 1.1 % level.

Ofgem state that they agree with those respondents who suggested that daily UIG is made up largely of temporary settlement or profiling error that will be corrected through subsequent reconciliation rather than being permanent unidentified gas and that they consider the figure of 3.5% of throughput cited in the FMR (being the difference between the average UIG figure of 4.65% and the previous unidentified gas figure of 1.1%) to be a reasonable approximation for the scale of settlement error.

However, if it was genuinely believed within the industry that UIG would settle at the 1.1% level then Modification 645 would not have been raised, received widespread industry support and been approved for implementation by the UNC Modification Panel. This provides a very strong vindication that there is widespread view in the industry that the 1.1% AUGE UIG level is unlikely to be achieved.

Given the time that has now elapsed since the representations on the UIG modifications it would be very useful to get views as to whether respondents still believe that of the 4.65% UIG that 3.5% is indeed settlement error which is believed will eventually come back through reconciliation. It is looking less and less likely with each passing month that the residual amounts of UIG at the Code Cut-Off date will be at this level once all possible reconciliation has been undertaken.

We think that with the likely high levels of permanent UIG a greater take up of the more advanced settlement products is likely to have only a very limited effect on this problem.

4. Do you consider that the AUGE terms of reference should be amended such that it has the explicit objective of developing a methodology that incentivises shippers to reduce unidentified gas?

We do not believe that it should be within the scope of the AUGE to develop the UIG weighting factors with the specific objective of, or with explicit regard to, influencing shipper behaviour. As we believe there is an inherently much higher level of UIG due to the factors outside of shippers' control, any incentives put forward by the AUGE could have a detrimental impact on customer in some products due to the levels of UIG which cannot be solved under the current governance arrangements and which should, therefore, be based on throughput. Any factors developed by the AUGE could end up with an allocation that is as unfair as those proposed in Modifications 0642 and 0643 and be imposed in a penal manner on shippers that are unable to lower UIG.

Whilst we agree that the AUGE has, in the past, helped incentivise and led to shippers being incentivised to tackle certain issues that contribute to UIG, such as unregistered and shipper-less sites, we do not agree with the results of the AUGE's current analysis of permanent UIG which is showing it to be 1.1%.

We do not agree that having the fixed UIG values instead being subject to periodic review by the DESC as proposed in UNC642A would be a retrograde step. DESC, which currently meets on a circa quarterly basis, could be able to meet on a more frequent basis and given the level of concern around UIG in the industry and the level of participation in UIG workshops to date, the industry would be able and willing to dedicate the necessary resources. Also, this committee would be able to change the factors on a much more frequent basis based on experience, compared to the AUGE who currently calculates a final annual set of allocation figures approximately 6 months before the start of the gas year. We believe that the output of that committee (or of the UNC Committee if a matter is escalated to it), being made up of industry representatives, could be very dynamic with all attendees working together to solve the same problems, as whilst the AUGE is independent, it is made up of a small number of people that do not have exposure to the daily effects of volatile and high levels of UIG.

A committee such as DESC could call on the expertise of dozens of industry experts from different companies and backgrounds for its analysis. Also, this committee would have the direct involvement of Xoserve, who we consider to be in a much better position than the AUGE in being able to identify the causes of UIG with its relevant expertise and data (especially with the recently announced UIG

task force being set up) and who could help derive the UIG figures. Also, this committee would not have any issues with admitting to errors and making adjustments, which they potentially could do on a frequent basis. Whilst the AUGE is independent and won the competitive tender to provide the service, it does not mean they have the correct view, and past experiences of the current AUGE has seen them make key decisions on their annual statements, following representations, that some parties did not agree with, resulting in a question mark over their reputation within the industry.

Shippers have years of experience of the gap between sales and purchases where the AUGE carries out what is an academic exercise of data modelling with some, what we consider to be incorrect assumptions, and that going back to the two reasons above for UIG is assuming that issues due to shrinkage, venting, etc. are zero. On this note we would also welcome a new party in the role of the AUGE following the next tender for the role so that we could start afresh with a new 'expert' and a clean slate, should Modification 0642A not be implemented. Furthermore, the AUGE was originally appointed to determine allocations between SSP and LSP shippers, but in a group such as DESC all parties would work together to help resolve the issue of UIG.

We would welcome Ofgem seeking Xoserve's view of the true level of UIG, in order to gain the viewpoint of a second independent expert. We would also welcome Ofgem asking shippers and other interested parties, such as the transporters, their views of the permanent level of UIG should all UIG modifications be rejected, as we are of the view that some parties agreed with the AUGE's figures of 1.1% (and hence gave it credibility) to justify implementation of UNC 0642 or UNC 0643 which would be to their commercial advantage. This viewpoint can at least in part be corroborated by some of those parties who believed that UIG would end up at 1.1%, but who just a few months later are supporting the setting up of a CDSP team to look at the issue. This CDSP task force could feed into any UIG decisions taken by DESC, should Modification 0642A be implemented.

In summary, we continue to support Modification 0642A due to the reasons mentioned above, and would welcome any actions taken by Ofgem that are able to help the industry address our concerns around shrinkage, leakage, and temperature and pressure calculations which we believe will lead to a permanent lowering of UIG.