

Representation - Workgroup Report

UNC 0642 (Urgent) 0642A (Urgent) - Changes to settlement regime to address Unidentified Gas issues

UNC 0643 (Urgent) - Changes to settlement regime to address Unidentified Gas issues including retrospective correction

Responses invited by: **5pm on 08 February 2018**

To: enquiries@gasgovernance.co.uk

Representative:	John Welch
Organisation:	npower
Date of Representation:	08/02/2018
Support or oppose implementation?	0642 - Oppose 0642A - Oppose 0643 - Oppose
Alternate preference:	<i>If either 0642, 0642A or 0643 were to be implemented, which would be your preference?</i> 0642A
Relevant Objective:	d) Negative for 642/642A/643

Reason for support/opposition: Please summarise (in one paragraph) the key reason(s)

Summary Position

npower welcomes the opportunity to provide comments on the proposed UiG modifications, 642, 643 and 642A.

It is clear that unidentified gas remains the leading issue experienced in the gas retail market at the present time. As such, it is right that the efforts of the industry are concentrated on understanding and solving the issues encountered as soon as possible.

However, it is our belief that none of the proposed modifications offer a fully coherent resolution to the issue, and would in many respects represent a retrograde step for an industry that has been working to future proof its arrangements for a fully smart metered industry.

We set out the rationale for our position in this summary section, with more detail in the sub-sections following.

It is npower's belief that:

1. The current arrangements have not been given enough time to settle, and given that in the early months after Nexus there were a number of issues such as increased DM meter estimates, it is perhaps only now that true patterns are starting to emerge. Work on improving the algorithm should improve the situation further.
2. The rationale for modifications 642 and 643 are too inclined towards commercial considerations in favour of a small number of shippers to the extent that they would not solve the current issues, and would also create a new set of problems for the industry.
3. The development process for all three modifications has not been long enough or detailed enough to create a fully workable set of coherent principles for a change of this magnitude. No industry wide modelling or analysis has been presented to provide empirical evidence for any of the proposals.
4. We disagree with elements of the supporting statements presented: estimates of costs of £160m to the industry are exaggerated and based on simplistic assumptions. The overall cost of gas supply has not increased in the UK market since Nexus. We also believe that the volatility and level of UiG was correctly predicted by DESC analysis produced and published in February 2016 and February 2017.
5. We believe that a reversion to the pre Nexus demand algorithm would be a retrograde step that would reduce transparency of the true level of unidentified gas, which sits uneasily with the move towards Smarter Markets.
6. In Nexus, the gas industry has just completed an industry change of great complexity and cost. To undergo a major change to the arrangements so soon after delivery, we believe would represent a wholly unnecessary cost to shippers, transporters and ultimately consumers.

In summary, our strong preference is for work to continue to improve the existing algorithm to progress the accurate sharing of settlement energy to parties (through modification 644, review group 631 and DESC), whilst retaining the transparency of uncalculated energy that was a central principle behind the creation of the current regime.

Further points

Development process

The reduced timescale to develop the proposals through this process gives rise to a number of issues. Of course this is an inherent problem with urgent mods, and while we understand the need for urgency given the material impacts being reported, changes of this level of complexity, where the fundamental structure of the industry arrangements is

being altered, ideally need much more detailed consideration in terms of industry development time. All the modifications in our view suffer from the lack of development time available from the provided timescales, and the absence of industry modelling to allow parties to understand the full impact to their businesses. Given that the current arrangements took approximately nine years in total to create and implement, this feels an unsatisfactory level of time and consideration to direct changes of this magnitude. In addition the lack of modelling and analysis could lead to unforeseen consequences and create perverse incentives that could introduce new and additional problems for the industry.

At least one issue that this gives rise to with each of the proposals (to differing degrees), is a lack of full coherence across all the components of the proposed arrangements – in contrast, the current post Nexus arrangements demonstrate a clear set of mechanics where energy is adjusted in one component, and a fully logical movement elsewhere takes place. This point can be demonstrated in the current development process by the fact that parties still had questions in the final workgroup meeting which led to changes to the examples presented, and therefore the modification document itself.

Statements

npower would like to comment on statements made in the modification documents to support the need for these proposals.

Modification 642 and 643 both state that the energy allocation model 'is misallocating gas to the end consumer' which is resulting in industry costs of £160m per year. We believe this is a simplistic and erroneous representation of the issue. While it is clear that the energy allocation algorithm is not performing optimally, reconciliation trends demonstrate that this under representation of demand has been experienced by all sectors of the market. Given that that energy has later been reconciled to these sectors through the meter read submission process, it is clear that the initial allocation in some part represented energy used by those sectors. As such, £160m represents an over-simplification and inflation of the issue, which we believe is unhelpful to the debate, and a problematic message to be sending to consumers.

Additionally, these levels of non-attributed gas were intrinsic to the previous regime, but were hidden due to the lack of transparency and granularity, and the different use of terminology.

Furthermore, reference is made in the modification proposals documents for 642 and 643 to 'unexpected levels of volatility'. npower believe that the modelling undertaken by the Demand Estimation Sub-Committee (DESC) in February 2016, (where data was modelled on the new algorithm back to 2011, and which was subsequently updated in February 2017), appropriately and correctly predicted the levels and volatility of UiG experienced following Nexus go-live. This analysis was published with enough lead time to allow parties to take steps to understand and adjust to the impacts on their businesses.

Algorithm

We feel that modification 642 proposes use of an algorithm that would represent a retrograde step for the industry. One of the key principles behind the post Nexus algorithm structure was the visibility that would be afforded by revealing the amount of energy that was not shared at allocation through the demand process including weather adjustments. Prior to Nexus, the demand estimation process concealed the effects of these errors within scaling factors, and by use of a weather correction factor that used demand as its basis (therefore not representing a true 'weather' correction factor). This allowed masking of the effect of allocation of costs to remain inherent in the process. It is our view that the proposal to return to this structure would be a backward step for an industry that has been working towards future proofing its arrangements for the full rollout of smart meters across the country. Modification 643 also suffers from this problem.

The length of time that would be needed to implement a system that reverts to this sub-optimal solution would in all likelihood need to be changed in the near term, to take advantage of the additional transparency more frequent smart meter readings would provide. We believe this adds unnecessary cost and complexity to the industry change pipeline that already contains numerous important and complex delivery items.

Fixed UiG

Modifications 642, 643 and 642A all propose the introduction of the concept of fixed unidentified gas. While we recognise the desire for certainty and predictability we note a number of issues with each of the modification proposals in this area.

Modifications 642 and 643 put forward the use of the AUGE estimate (currently 1.1% of throughput) for use in UiG distribution at the allocation stage of the energy balancing process. This figure is currently untested, as the new arrangements have not had time to unwind to reveal the true extent of genuine unidentified gas (which was a principle inherent within them). As these proposals also include no process to later correct this sharing mechanism, there is a danger that parties will have received shares of energy that are incorrect and inappropriate with no structure for later adjustment.

It should also be noted that the current AUGE arrangements do not obligate the AUGE to calculate an estimate of UiG, simply to create weighting factors for the re-distribution of UiG. The fact that they do so is the choice of the AUGE incumbent in how they fulfil their obligation. Given this calculation is an incidental part of the process it would be a mistake to lend such weight to it in any set of structural arrangements.

Modification 642A proposes a fixed level of UiG set at 2.5%. While this appears a more conservative figure, which is welcome, the rationale for the amount, as it is based on the proposer's own portfolio analysis, is not transparent (although we note that the proposer will be sharing their analysis with the authority to support a decision).

Furthermore, given that the modification proposes retaining the existing post Nexus demand estimation algorithm (which we support), apportioning a fixed UiG and balancing

quantity element across the uncalculated element, does little more than separate that initial energy into two re-named quantities.

Sharing factors

Modification 642 and 643 propose that 'settlement error' should be distributed across the industry using sharing factors that would be distinct from the UiG weighting factors (while using the same factors initially). We understand the rationale for this but would question whether the AUGE would be the best placed party to perform such analysis. As an element of this type of error will always be due to algorithm and profiling errors, DESC seem best placed to perform such a function.

Reconciliation

Modification 642 proposes a mechanism to smear any energy adjustments due to meter point level reconciliation, to meters that have not had a read accepted and reconciled into the settlement process in a given month. One problem with this proposal is that the underlying idea behind it seems to make the binary suggestion that sources of energy calculation error are wholly attributable to whether or not reads have been submitted. While we certainly would not argue against accurate meter reads being a crucial element in accurate settlement, as we have seen since Nexus go-live, there are many other sources of error than contribute to inaccurately estimated settlement (DM read issues, WAR band profiles, inaccurate AOs, incorrect data), which affect all parts of the market. While modification 643 offers some welcome additional complexity, it retains this inherent binary emphasis on read submission, which we feel does not take account of the multiple sources of error which lead to unidentified gas. As such, we continue to believe that the industry Performance Assurance Committee (PAC) remains the best vehicle to ensuring these sources of error are controlled, monitored and shipper data quality is incentivised in a balanced and equitable fashion.

This element of the proposal would represent a skewing of the industry arrangements against shippers with a largely domestic portfolio, towards those parties with a largely non-domestic portfolio. Some parties may need to incur additional meter reading costs in the medium term at least until such point as wider smart roll-out is achieved. We feel that proposals that provide such an outcome are not helpful, and do not solve the industry's problems in such a way that would be equitable and enduring.

We believe modification 642 in particular, but also modification 643, propose a retrograde step with mechanisms that are not dissimilar from the RbD system that the industry has worked for years to move away from.

Retrospection

Modification 643 puts forward the notion that all previous financial positions should be corrected back to 1st June 2017, using the newly proposed set of arrangements. We believe there is no basis for such a proposal, and that industry parties have acted in good faith since June 2017, balancing and trading positions using the agreed and signed off arrangements and systems. The existing system has been signposted for a number of years, with appropriate time and information for all parties to prepare appropriately and we believe it would be inequitable and unworkable to attempt to correct these positions made in good faith by industry participants to date.

We also note that there is an element of potential retrospection built into the modification 642 proposal due to the request for an April / May / June 2018 implementation date for the modification, and the fact that xoserve have indicated that they would not be able to deliver systems to this timescale. The proposer has indicated that they believe it is possible for parties to trade using existing systems while having an understanding of the implemented arrangements they would ultimately be working to. We believe this a completely unrealistic and unworkable proposition, and would create entirely unnecessary additional complexity for the majority of the industry, while creating an untenable environment for new market entrants to attempt to operate within.

Summary

The proposals within modifications 642 and 643 would lead to changes to the current arrangements which would balance the regime in favour of a small number of shippers with specific types of non-domestic portfolio. We believe this does not provide a solution to the current problems in the industry, but a clear way of creating a new set of problems, which would leave the industry discussion unresolved, and lead to further confusion and debate.

While modification 642A attempts to offer an alternative proposal to solve the problems experienced by the industry, we believe the constrained timescale has not allowed enough work to be undertaken for the industry to develop it fully. As a result, as a solution, it would not go far enough to resolve the issue in a way that is equitable and enduring.

npower believe that while unidentified gas remains a central concern of the industry, it is imperative that the industry does not rush into taking a backward step by implementing retrograde changes to a set of arrangements that have taken the best part of ten years to build. These arrangements have at least one central aim of future proofing the regime for the development of smart meter roll-out.

Our strong preference is for work to continue to improve the existing algorithm to improve the accurate sharing of settlement energy to parties, whilst retaining the transparency of uncalculated energy that was a central principle behind the creation of a regime still in its infancy.

Implementation: *What lead-time do you wish to see prior to implementation and why?*

xoserve have provided indicative timescales for each of the modifications. It is clear that the earliest that any of these proposals could be delivered to the industry is February / March 2019. Given the complexity of the proposals, we believe it is not unreasonable for delays to be encountered during deliveries of this complexity, and given there would likely be an appetite for the industry for a reasonable market trials exercise, these timescales could quite easily increase in length and cost. Project Nexus provided multiple examples of how managing change across the industry can result in unexpected complexity and ultimately, delay.

We also believe that the costs estimated by xoserve, as well as further costs that would be incurred by shippers to alter their own systems, represent an unnecessary and superfluous outlay, which would ultimately be borne by consumers, for under-developed, unquantified proposals that may not resolve any of the industry issues.

Given the potential complexity of any of the proposals, we believe a lead time of at least 12 months would be required, not including any market trials exercise.

Impacts and Costs: *What analysis, development and ongoing costs would you face?*

While the shorter development process has meant we have not been able to undertake a full impact analysis, we believe the impact of 642 and 643 to central systems, shipper systems, and shipper and supplier business processes to be significant. While 642A looks to retain elements of the existing arrangements, which should lead to comparatively lower impact change to central systems, we would still expect to incur significant project costs, with associated changes to business processes.

Legal Text: *Are you satisfied that the legal text will deliver the intent of the Solution?*

npower were disappointed that the opportunity to refine the terminology related to unidentified gas was not taken through the development workgroup process in relation to modifications 642 and 643. Following feedback, legal text was created for the modifications that attempted to define the concepts of unidentified gas and the new concept of 'settlement error'. We feel that both definitions did not go far enough, and if implemented would leave poorly defined concepts within UNC code that would have detrimental effects in future. We believe that one element in the problems experienced by the industry since Nexus go-live has been difficulties for some parties in translating what the new energy components represent, and how they compare to energy components prior to Nexus. We would not welcome arrangements that further compound this issue by introducing ill-defined concepts into UNC code.

To continue this point, the proposed definition of settlement error as essentially everything other than that measured through meter readings, reveals the simplistic rationale behind this element of the proposal. Our concern is that such a definition would cause problems in understanding, and seek to create and define an inaccurate narrative about the true causes of settlement error.

Are there any errors or omissions in this Workgroup Report that you think should be taken into account? *Include details of any impacts/costs to your organisation that are directly related to this.*

We would like to highlight the lack of industry wide supporting modelling, analysis or empirical evidence, for a change of this scale.

Please provide below any additional analysis or information to support your representation

No further points to add.