

0550:

Project Nexus – Incentivising Central Project Delivery.

- 01 Modification
- 02 Workgroup Report
- 03 Draft Modification Report
- 04 Final Modification Report

This Modification proposes to introduce incentive payments from Gas Transporters should the implementation of Project Nexus be further delayed beyond 1st October 2016 because of transporters' failure to deliver.



The Workgroup recommends that this modification should now proceed to Consultation.



High Impact: Shippers and Transporters.



Medium Impact: None



Low Impact: None

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About this document:		
This report will be presented to the Panel on 18 February 2016.		 07788 309163
The Panel will consider whether the modification should proceed to Consultation or be returned to the Workgroup for further assessment.		Transporter: National Grid Distribution
The Workgroup recommended the following timetable:		 chris.warner@nationalgrid.com
Initial consideration by Workgroup	08 September 2015	
Amended Modification considered by Workgroup	13 January 2016	
Workgroup Report presented to Panel	18 February 2016	
Draft Modification Report issued for consultation	18 February 2016	 07778 150668
Consultation Close-out for representations	10 March 2016	Systems Provider: Xoserve
Final Modification Report presented to Panel	17 March 2016	 commercial.enquiries@xoserve.com
UNC Modification Panel recommendation	17 March 2016	Additional contacts: Steve Nunnington
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1 Summary

Is this a Self-Governance Modification?

The Modification Panel determined that this is not a self-governance modification because it is likely to have a material impact on the commercial activities connected with the shipping and transportation of gas since it introduces the potential for financial payments by the transporters and is expected to require financial transactions between industry parties.

Is this a Fast Track Self-Governance Modification?

Fast Track does not apply because this is not a housekeeping matter.

Why Change?

Modifications 0432 and 0440 were approved by Ofgem in February 2014 and January 2015 respectively. Prior to the approval of these modifications the industry was already working towards an implementation date of 1st October 2015. This 1st October 2015 date was established as a result of a stated desire by Ofgem in 2012 that the revised settlement functionality should be delivered by the 4th quarter 2015. On reviewing this requirement there was broad industry consensus to reset the implementation date for the relevant modifications as 1st October 2016.

Gas Shippers consider that they will be ready for 1st October 2016, but are concerned that the Transporter Agency will not meet this date, resulting in a delay to the modifications and delivery of the systems solution.

This modification seeks to address the lack of commercial incentive on the Gas Transporters associated with the delivery of Modifications 0432 and 0440.

Solution

This proposal seeks to introduce an incentive payment scheme that will be triggered upon Authority Direction of the implementation of a UNC Modification that delays the Project Nexus Implementation. If one or more of the Transporters are determined to be responsible for a specific failure, leading to a deferral of the implementation date, payments will be made to Shippers and to a charity nominated by transporters. For clarity the Project Nexus Implementation date (applicable for this modification) is 1st October 2016.

Relevant Objectives

This proposal has a positive impact on relevant objective f): promotion of efficiency in the implementation and administration of the Code. It is believed that an appropriate financial incentive will encourage Transporters to take all necessary action to ensure that Project Nexus is delivered by 1st October 2016, ensuring that the new UNC obligations under Modifications 0432 and 0440 can be met.

Implementation

This modification should be implemented at the earliest possible date following the Authority's Decision.

Does this modification impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

This modification relates to the industry programme for the replacement of UK Link systems, since it defines a backstop implementation date. It does not however propose any changes to the functionality or the proposed solution and therefore should have no impact on the existing approved Project Nexus modifications.

2 Why Change?

Modifications 0432 and 0440 were approved by Ofgem in February 2014 and January 2015 respectively. Prior to the approval of these modifications the industry was already working towards an implementation date of 1st October 2015. This 1st October 2015 date was established as a result of a stated desire by Ofgem in 2012 that the revised settlement functionality should be delivered by the 4th quarter 2015. On reviewing this requirement there was broad industry consensus to reset the implementation date for the relevant modifications as 1st October 2016.

Once an implementation date is set the industry plans for that date and expects delivery to be met. There are currently no commercial arrangements within the UNC to incentivise delivery. It is simply expected to happen.

The industry planned and commenced work to meet the implementation date. Following concerns raised by the industry regarding the overall approach to industry planning and assurance, Ofgem appointed PwC to assess industry readiness. PwC commenced work in April 2015.

On 1st May 2015, PwC published the findings of its industry assurance assessment after reviewing iGT, GT and Shipper delivery plans for 1st October 2015. PwC found that organisations had built their delivery plans “right to left” focussing on the prescribed end date of 1st October 2015 and many plans were incomplete. Approximately 60% of organisations would not have completed build activities in time to take part in L1 Connectivity Testing and L2 File Format testing, therefore resulting in an incomplete and ineffective Market Trials period. In addition, Xoserve widely reported its delivery plan was built “right to left” and contained high levels of parallelism in order to achieve the implementation date and was not the approach it would ordinarily endorse. PwC recommended an exercise be undertaken to determine the most appropriate implementation date. At the time of the recommendation from PwC to replan the implementation date, a number of file format changes, found through Xoserve testing activities, were required to be addressed.

The industry re-planned (on a “left to right” basis) the programme of works and established a revised implementation date of 1st October 2016 for the modifications. Urgent Modification 0548 reset the implementation date to 1st October 2016.

Shippers consider that they will be ready for 1st October 2016, but are concerned that the Transporters will not meet this date, resulting in a delay to the modifications and delivery of the systems solution.

A key part of the RIIO process is ensuring the incorporation of incentives within the price control structure that deliver value for customers. It is the view of the Proposer RWE that any further delay to the Nexus programme will inflict unnecessary further costs on consumers, particularly as significant changes are expected across the industry over the next five years, and therefore there should be some incentive introduced in this area.

This modification seeks to address the lack of commercial incentive on the GTs associated with the delivery of Modifications 0432 and 0440.

3 Solution

Outline of the Payment Incentive Scheme

To incentivise Gas Transporters to deliver the system solution on time, it is proposed to introduce a payment incentive scheme that will be triggered in favour of Shipper Users and a charity nominated by transporters if non-delivery is due to a specific failure by one or more of the Gas Transporters and the

delivery date is not achieved. The incentive payments are to be assessed at a monthly rate of £5m or part of this sum dependent on the period of time that delivery remains outstanding. The Proposer has anticipated that a rescheduled mid monthly go live is a low probability, however the Solution accommodates such an event. The incentive payments will be capped to a period of two months.

Half of the payment incentive scheme will be distributed to Gas Shipper Users based on market share supply point count on the 1st October 2016. Payments will be expected to be made in the month following the relevant month of delay. This will be performed using the current transportation invoicing process. The remaining half will be redistributed to the charity nominated by transporters.

For the avoidance of doubt, the scheme applies only to the large transporter organisations. Any specific failure by any other party does not trigger the scheme.

Supporting Information

To provide industry with assurance that the scheme is set at a relevant level, the amount of these payments was intended to be defined by the UNC Governance Workgroup. There is little information available and Xoserve have been unable to provide either their cost liabilities (due to commercial reasons) or an accurate assessment of the cost of Project Nexus. Due to this the proposer has chosen a value of £5m per month to place on the incentive scheme.

The proposer acknowledges that this value is not considered accurate by some parties. The intention of this modification is to provide a suitable value for an incentive payment. Due to the nature of an incentive payment it is not required to be an accurate or genuine pre-estimate of Gas Shipper loss. It is provided to incentivise delivery and is not required to compensate Gas Shippers for loss however in this case the proposer feels that this value is relevant and reasonable and is believed to be roughly 10% of the costs of the initial delivery programme previously estimated at £70m whilst no other industry information has been forthcoming.

For the avoidance of doubt the Modification proposes that the Gas Transporters meet the costs of any incentives from shareholders and not through transportation allowances.

Business Rules

Phrases in italics are to aid understanding and not for inclusion in Code

1. ***How does the scheme become live?*** The trigger for the scheme to become active is if the Project Nexus Implementation Date for functionality associated with Modifications 0432 and 0440 of 01 October 2016 is not achieved.
2. ***How are transporters determined to be liable?*** A modification is successfully implemented through Authority direction that defers the Project Nexus Implementation Date as a consequence of one or more of the large Gas Transporters' specific failure.

The demonstration of this will be via Authority determination only, in writing, describing the specific transporter failure that led to the deferral of the Project Nexus Implementation Date.

If the Authority does not identify a specific transporter failure the scheme closes at this point.

3. ***How much are Transporters liable for and how is it distributed?*** The Transporter Incentive Payment of £5m per calendar month (or part of) will be paid on a (calendar) daily pro-rata basis. Incentive Payments will be distributed as follows:
 - a. 50% of the Transporter Incentive Payment will be paid to Shipper Users based on Shipper Users proportion of Supply Point counts as at 01 October 2016. Payments/invoicing will be made in line with TPD Section S.

- i. Where a Shipper User's individual aggregate payment under this scheme is <£100, a default payment of £100 will be made. For the avoidance of doubt, such sums are to be taken from the overall scheme amount.
- b. 50% of the Transporter Incentive Payment will be paid to a charity nominated by transporters and ratified by the Authority. The timeline for such payments will be agreed with the Authority.

4. **What is the limit to the scheme?** The Transporter Incentive Payment will be capped at £10million.

User Pays	
Classification of the modification as User Pays, or not, and the justification for such classification.	No User Pays service would be created or amended by implementation of this modification and it is not, therefore, classified as a User Pays Modification.
Identification of Users of the service, the proposed split of the recovery between Gas Transporters and Users for User Pays costs and the justification for such view.	N/A
Proposed charge(s) for application of User Pays charges to Shippers.	N/A
Proposed charge for inclusion in the Agency Charging Statement (ACS) – to be completed upon receipt of a cost estimate from Xoserve.	N/A

4 Relevant Objectives

Impact of the modification on the Relevant Objectives:	
Relevant Objective	Identified impact
a) Efficient and economic operation of the pipe-line system.	None
b) Coordinated, efficient and economic operation of <ul style="list-style-type: none"> (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters. 	None
c) Efficient discharge of the licensee's obligations.	None
d) Securing of effective competition: <ul style="list-style-type: none"> (i) between relevant shippers; (ii) between relevant suppliers; and/or 	None

(iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers.	
e) Provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards... are satisfied as respects the availability of gas to their domestic customers.	None
f) Promotion of efficiency in the implementation and administration of the Code.	Impacted
g) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.	None

This proposal mitigates the risk of Project Nexus not being delivered because it incentivises Transporters to take actions designed to deliver on time. This furthers relevant objective f): efficiency in the implementation and administration of the code, because the UK Link system is central to the new gas settlement regime implemented under Modifications 0432 and 0440.

Transporter representatives disagreed, believing that there was a negative, or no, impact on relevant objective f) since they already have a best endeavours obligation introduced under Modification 0548. They also believe that there are no further activities available to them to increase the likelihood of delivery on time, beyond those in place at the current time. Further concerns (including that the principle is untested, it is without wider scrutiny of the industry) were expressed about the precedent set by this proposal, without due consideration. Transporter representatives believed that the scheme was not in fact an incentive (which should be balanced) but a penalty scheme, which was believed to be unlawful.

In response, Shipper representatives explained that this situation is more akin to a traditional service provider contract, where incentives to deliver on time are commonplace. They added that it was understood that Transporters had such arrangements with their own Nexus suppliers and that it would not be unreasonable to extend this to Shippers. Addressing the introduction of precedent without due consideration, Shipper representatives pointed out that the assessment of this proposal under the auspices of the Governance Workgroup was in itself due industry consideration. Further, the concept of incentives is not new to the UNC nor to Licencees, under RIIO. Finally, Shipper representatives disagreed with Transporters, believing the scheme to be lawful.

Shipper representatives added that, throughout the assessment process, they had asked for financial information (total contract value and/or liabilities) to help them to assess the level of payments. Transporters pointed out that this information was commercially sensitive and would not be shared. It was suggested that this lack of clarity added to the uncertainty in developing the modification, and that the materiality of the proposed incentive scheme could not be validated beyond the level of materiality shown in the Solution.

Some Shipper representatives disagreed about the capacity of Transporters to act differently, citing earlier discussions about potential mid-month implementation as an example of something that could be done differently.

Transporter representatives expressed some concerns about the proposal for Ofgem to have sole determining authority for cause of any delay. In particular, that there may be a lack of transparency of Ofgem's consideration in their assessment of accountability for failure to deliver. They requested that

Ofgem should set out the process and, preferably, the criteria they will use to assess accountability at the time of direction on this modification.

5 Implementation

No implementation date has been specified, however an early decision by the Authority would provide certainty to the industry as to the expected delivery of Project Nexus on 1st October 2016.

6 Impacts

Does this modification impact a Significant Code Review (SCR) or other significant industry change projects, and if so, how?

This modification is relevant to implementation of the UK Link Replacement programme, however it has no impact other than to incentivise delivery.

Precedents

In recognising the unusual circumstances of this proposal, Panel requested that the Workgroup consider any precedents in other energy sector Codes.

On behalf of the Workgroup, the Joint Office made enquiries with the relevant Code Administrators and discovered that there were no direct comparative incentive schemes in other Codes. Workgroup participants confirmed that they also had no knowledge of similar schemes elsewhere in such Codes.

The Workgroup considered the arrangements in Supply Point Administration Arrangements SPAA Schedule 34 of the Theft Risk Assessment Arrangements (TRAS) – which are paralleled in the electricity DCUSA (Distribution Connection and Use of System Arrangements) – to address the late submission of data by Suppliers, which is on the implementation project's critical path. Failure to submit the data may compromise the implementation of the project and relieve the TRAS Service Provider of obligations to subsequent milestone dates. The TRAS arrangements have therefore been drafted such that failure by a Party to submit data in accordance with the Code will constitute a breach of the Code, but may result in additional costs that the SPAA Executive Committee and DCUSA Panel have the ability to recover directly from the Party in breach.

Participants believed that these arrangements were in fact different to those proposed in Modification 0550, as they directly compensated costs incurred, but that this should be recorded for completeness in the Workgroup's Report.

In addition, brief consideration was given to the TRAS Incentive Scheme, which creates a performance incentive pot intended to encourage Suppliers to detect theft of gas (the pot is c.£8m for year one of the scheme). Some participants observed that Ofgem's recent decision to support the scheme under CP15/292 was worthy of reference as a direction set in recent times. Other participants felt this was entirely dissimilar, as it was not about a single delivery project.

Typical Commercial Incentives

Workgroup participants noted that it is normal commercial practice for service providers to be incentivised to deliver to target with financial adjustments. Shipper representatives drew reference to the arrangements that had been acknowledged between the Transporter's Agent and their systems developers by way of example. Transporters countered that it was more conventional to set such incentives at the onset of a delivery contract and not during delivery, as could be observed to be the case here. Transporters also observed that, in such commercial arrangements, it was usual to price a risk

premium into those service provider's contracts, which was not possible in the UNC. Shippers felt that it was not clear how any payments received by the Transporter's Agent (from their providers) would feed back in to the overall project accounting.

7 Legal Text

Text Commentary

A Legal Text Explanatory table has been provided and is published alongside this report.

Suggested Legal Text

The following text has been provided by National Grid Gas Distribution. The workgroup has considered the text and no issues were raised.

TRANSITION DOCUMENT – PART IIC

Insert new paragraph 22 to read as follows:

22. Delay in implementation of Modifications 0432 and 0440

22.1. This paragraph 22 shall apply in the event:

- a) any Modification ("**Delay Modification**") is made pursuant to which Modifications 0432 and 0440 are to be implemented on a date later than the 01 October 2016; and,
- b) the reason(s) for the Delay Modification is due to a delay in the implementation of the Transporter Agency's UK Link replacement programme caused by a specific action or actions on the part of one or more of the Transporters; and
- c) the Authority makes a determination that the requirement for the Delay Modification is for the reason(s) described in paragraph (b).

22.2. The "**delay period**" is the period from 1 October 2016 until the earlier of:

- a) the day preceding the Project Nexus Implementation Date for Modifications 0432 and 0440; or
- b) 30 November 2016.

22.3. Subject to paragraph 22.4, in respect of each day in the delay period the Transporters shall pay each Shipper User an amount (the "**daily delay charge**") calculated as follows:

$$(\pounds 2,500,000 / D) * (SSP / ASP)$$

where:

D is the number of days in the Month in which the day falls;

ASP is the number of Supply Points identified in the Supply Point Register at the start of 1 October 2016;

SSP is the number of such Supply Points in respect of which the Shipper User is the Registered User.

- 22.4. Where following calculation of the daily delay charge for the last day in the delay period ("**last delay day**") the aggregate daily delay charges payable to a Shipper ("**relevant Shipper**") by Transporters in accordance with paragraph 22.3 is less than £100:
- a) the daily delay charge for the last delay day shall be increased by an amount ("**uplift amount**") such that the aggregate daily delay charges payable by Transporters to the relevant Shipper equals £100; and
 - b) the daily delay charge for the last delay day for each other Shipper shall be decreased by an amount equal to:

$$\text{AUA} * (\text{SSP} / \text{ASP})$$

where:

AUA is the aggregate of uplift amounts payable to relevant Shippers;

SSP and ASP have the meaning in accordance with paragraph 22.3.

- 22.5. Where the Transporters are liable to pay daily delay charges the Transporters shall make a payment to such charitable organisation as the Transporters and the Authority shall agree of an amount equal to the aggregate daily delay charges payable by the Transporters in accordance with this paragraph 22.
- 22.6. Daily delay charges shall be invoiced and payable in accordance with TPD Section S.
- 22.7. This paragraph 22 is not a Compensation Rule.

8 Recommendation

The Workgroup invites the Panel to:

- AGREE that this modification should be submitted for Consultation.