

## Representation - Draft Modification Report 0550

### Project Nexus: Incentivising Central Project Delivery

Responses invited by: **10 March 2016**

To: [enquiries@gasgovernance.co.uk](mailto:enquiries@gasgovernance.co.uk)

<b>Representative:</b>	Phil Lucas
<b>Organisation:</b>	National Grid NTS
<b>Date of Representation:</b>	9 <sup>th</sup> March 2016
<b>Support or oppose implementation?</b>	Oppose
<b>Relevant Objective:</b>	f) None

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

National Grid NTS does not support implementation of this Proposal as it seeks to impose an inappropriate and arbitrary additional cost upon Transporters in the event that delivery of UK Link replacement systems (necessary to implement UNC Modifications 0432 and 0440) occurs after 1<sup>st</sup> October 2016 and Transporters are deemed to be partially or exclusive at fault for the delay. This cost would be in addition to any implementation costs incurred by Transporters over and above the respective allowance in each Transporter's price control arrangements. In our opinion, this in itself creates an effective incentive for Transporters to deliver UK Link replacement systems in a timely manner to avoid additional cost exposure<sup>1</sup> which would not be recoverable from Shippers through use of system charges.

Given that the expressed intention of the Proposal is to "*address the lack of commercial incentive on the GTs associated with the delivery of Modifications 0432 and 0440*" which as stated above, we believe is not the case, we do not agree that implementation of this Proposal would better facilitate relevant objective f) of the Code.

#### **Implementation:**

We are not aware of any specific implementation requirements with an associated development timescale and therefore do not believe there is any specific lead time necessary for implementation (if the appropriate direction is given by the Authority).

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<sup>1</sup> An example of such a cost driver is the recent deferral of the implementation of elements of Retrospective Adjustment arrangements (Modification 0573) to October 2017. As highlighted in our representation to Modification Proposal 0573, it is highly probable that National Grid NTS will be exposed to a level of additional costs incurred as a consequence of the need for an extended system development programme.

## Impacts and Costs:

Implementation would impose an additional cost risk on Transporters as described in the Draft Modification Report.

## Legal Text:

National Grid NTS is satisfied that the legal text principally delivers the intent of the solution advocated by this Modification Proposal.

However, we maintain some concerns that the criteria and process by which the Authority makes a determination that Transporters are culpable for the specific action/s necessitating the Delay Modification are not explicit.

## Are there any errors or omissions in this Modification Report that you think should be taken into account?

National Grid NTS believes that in addition to the absence of the process and criteria for the Authority's determination of Transporter culpability as described above, there is a lack of clarity in the Draft Modification Report in the following areas (further described in the following section):

- rationale for the proposed apportionment of incentive revenue between Shippers; and
- rationale for the stated 'reasonable and relevant' nature of the proposed incentive value (beyond being stated as roughly 10% of the costs of the initial delivery programme).

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

Further to the high-level reasons for our lack of support for implementation described above, our detailed views are as follows:

### Measures Taken to Facilitate Timely Delivery

National Grid NTS has taken action in the following areas (where necessary in conjunction with the industry) to maximise the likelihood of meeting the delivery date for UK Link replacement systems (necessary to implement UNC Modifications 0432 and 0440):

- *Programme escalation* – National Grid NTS actively engages with other members of the Xoserve Board and provides direction and approval in respect of measures believed necessary to secure timely delivery of the UK Link Replacement Programme;
- *UK Link Replacement Programme budget* – National Grid NTS has sanctioned, in a timely fashion, incremental increases to the programme budget at Xoserve

Board level. We understand that this has enabled Xoserve to commit additional resource to the Programme;

- *Prioritisation of change workload* – National Grid NTS has agreed to the deferral of analysis work in respect of a number of ‘Business as Usual’ change requests to enable Xoserve resources to focus on delivery of UK Link Replacement;
- *Project Nexus Steering Group (PNSG)* – National Grid NTS is actively participating as a voting member in steering group oversight and control of the industry plan to deliver UK Link Replacement systems. National Grid NTS objectively reviews information presented to the PNSG and votes in support of measures that it assesses as affording the best opportunity for the industry to meet the proposed delivery date; and
- *Operational participation* – National Grid NTS has also supported the programme at an operational level, for example timely participation in the various stages of Market Trials and provision of timely responses to PwC questionnaires issued via the online portal.

### **Appropriateness of the Incentive**

Imposition of additional financial risk for Transporters of this type, and at this time, is inappropriate on the basis that this risk should be apparent at the outset of the relevant programme of works. The risk should be transparent so that it can be taken into account, both in terms of implementation timescales and service procurement arrangements and costs. Setting incentives late in a system delivery programme also creates a precedent for any UNC party to seek the imposition of incentive arrangements on other UNC parties responsible for any systems development (required to effectively implement a UNC Modification) part way through that development process. From a Transporters’ perspective this would make it potentially necessary to consider contingency costs and specification of additional contingency time<sup>2</sup> (for implementation) at the outset of any future programme of this nature.

### **Arbitrary Nature of the Proposed Value**

The identified cost risk for Transporters is arbitrary in the sense that there is insufficient rationale for the level of ‘incentive’ determined by the Proposer. Whilst we acknowledge that commercial sensitivities potentially inhibited the Workgroup’s task of determining an appropriate level, a value of £10 million labelled as ‘*roughly 10% of the costs of the initial delivery programme*’ nevertheless represents an arbitrary value which has been deemed ‘*reasonable and relevant*’ by the Proposer with no further rationale as to why it is such apparent in the Draft Modification Report.

Distribution of the incentive revenue between Shippers is also subject to an arbitrary apportionment methodology based upon the proportion of Supply Points for which the Shipper is the Registered User as at 1<sup>st</sup> October 2016. The Draft Modification Report details no summary or detailed explanation as to *why* certain Shippers are entitled to a

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<sup>2</sup> National Grid NTS previously recognised the challenging nature of the original Project Nexus implementation date of 1<sup>st</sup> October 2015 and sought deferral of this date via Modification Proposal 0491.

greater proportion of the potential incentive revenue than others based purely upon the identified criteria.

## **Effective Incentive Schemes**

National Grid NTS is firmly of the view that incentives of this nature should be set and determined by the regulator via Transporter licence arrangements for the allowance or disallowance of Transporter costs as (respectively) efficiently or inefficiently incurred. This would create a more proportionate and cost reflective incentive for Transporters to deliver. We recognise that commercial sensitivities of individual terms of bi-lateral service provision contracts can make it difficult for individual parties (or groups thereof) to obtain the information necessary to propose incentives at an appropriate and cost reflective level. Therefore, we believe that the regulator is best placed to make such a determination in light of the information it is able to obtain (by formal request if necessary).

Notwithstanding our view that the Proposed incentive scheme would not, in itself, effectively incentivise Transporters (as a sufficient incentive is, in reality, already in place via Transporters' existing price control arrangements), we note that typically, effective incentive arrangements feature 'upside' and 'downside' risk for the incentivised party<sup>3</sup>. The proposed scheme, however, encompasses only a downside risk for Transporters.

Furthermore, the extent of any shipper culpability for delay has no impact on the proposed level of incentive risk faced by Transporters under this Proposal (nor indeed the zero incentive risk faced by Shippers) which we do not believe is appropriate.

## **Determination of Transporter Culpability**

National Grid NTS is further concerned regarding the lack of definition of the process (including any rights of appeal) and criteria the Authority will utilise to make a determination that one or more Gas Transporters have been responsible for a 'specific failure' resulting in the need to defer the Project Nexus Implementation Date.

We believe that identification of such criteria is critical on that basis that allocation of culpability for delay by an individual party may be a subjective opinion formed on the basis of an incomplete view of the facts and understanding of drivers and therefore be open to challenge. Establishment of the relevant process and criteria in advance, and affording a right of reply/appeal prior to a conclusion being drawn, may go some way to mitigating this risk.

## **Legal Implications**

Whilst this Proposal seeks to introduce what is termed an "incentive" on Transporters, in practice it introduces an obligation on Transporters to make payment in circumstances where delivery of UK Link replacement systems (necessary to implement UNC Modifications 0432 and 0440) is delayed beyond 1<sup>st</sup> October 2016. In order for such a

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<sup>3</sup> As an example, Ofgem consultation document 12/12 "System Operator incentive schemes from 2013: principles and policy" [https://www.ofgem.gov.uk/sites/default/files/docs/2012/01/so-2013-principles\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2012/01/so-2013-principles_0.pdf) para 1.6 "we are minded to regulate the SOs in a way that is consistent with the following principles: the overall regulatory framework should reflect a fair balance of risk and reward"

provision to be legally enforceable the remedy (i.e. the incentive payment) that is imposed must not be disproportionate to the Shippers' legitimate interests in enforcing the Transporters' performance. National Grid NTS considers that the proposed remedy may be disproportionate and if so, the provision is penal in nature and is not legally enforceable.

As already highlighted above, the incentive payment has been set at an arbitrary level which is not reflective of the actual losses that Shippers' may reasonably expect to suffer in the event that delivery is delayed beyond 1<sup>st</sup> October 2016. As a result, the provision is seeking to protect a legitimate interest that goes beyond compensation for financial loss. No explanation has been provided in the Proposal as regards any broader commercial interests that the Shippers' would be looking to protect and in the absence of such commercial justification the provision may be considered to be penal in nature and therefore unenforceable.