

Modification proposal:	Uniform Network Code (UNC) 506V/506AV: Gas Performance Assurance Framework and Governance Arrangements (UNC506V/UNC506AV)		
Decision:	The Authority ¹ directs that modification UNC506V be made ²		
Target audience:	UNC Panel, Parties to the UNC and other interested parties		
Date of publication:	17 December 2016	Implementation date(s):	To be confirmed by the Joint Office

Background

Accurate settlement is a key requirement of both the electricity and gas industries. However, whilst electricity settlement has been subject to a performance assurance regime since the inception of the Balancing and Settlement Code in 1998, no equivalent has been established in gas.

The modification proposals

Both UNC506V and the alternative UNC506AV seek to establish a Performance Assurance Framework (PAF). In particular, a Performance Assurance Committee (PAC) would be established as a sub-committee of the Uniform Network Code Committee (UNCC). Under both proposals the PAC would be supported by PAF Administrator (PAFA).

However, the proposals vary in a number of key areas. In particular:

- UNC506V would require the Gas Transporters (GTs) to undertake a competitive procurement exercise to appoint a PAFA. Under UNC506AV there would be no such procurement, the PAFA role would be undertaken by the GTs agent, Xoserve;
- Whereas the performance assurance arrangements introduced by UNC506V would be enduring, UNC506AV includes a sunset provision under which the arrangements would cease to have effect three years from the Project Nexus Implementation Date.³

UNC Panel⁴ recommendation

At their meeting of 19 November 2015, UNC Panel accepted that requested variations to both UNC506 and UNC506A should be made, but that they were immaterial. UNC506 and UNC506A were therefore deemed to have been withdrawn and replaced by UNC506V and UNC506AV respectively, and that those proposals should continue from that point in the process.

The UNC Panel considered that both UNC506V and UNC506AV would further relevant objective (d). However, some UNC Panel members were concerned that UNC506V would

¹ References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.

² This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

³ On 13 August 2016 the Authority accepted [UNC548](#), which deferred the Project Nexus implementation date to 1 October 2016, or such other date as may be determined by the Authority.

⁴ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

be the more complicated of the two and therefore potentially detrimental or at least of less benefit to relevant objective (f).

The UNC Panel voted to recommend that each of UNC506V and UNC506AV be implemented, but took a second vote which determined that its preference between the two was for UNC506AV.

Our decision

We have considered the issues raised by modification proposals and the Final Modification Reports (FMRs), together with the consultation responses published alongside those FMRs⁵. We have concluded that:

- the implementation of either UNC506V or UNC506AV would better facilitate the achievement of the relevant objectives of the UNC;⁶
- of the two proposals, UNC506V would best facilitate those relevant objectives; and,
- directing that UNC506V be made is consistent with our principal objective and statutory duties.⁷

Reasons for our decision

We note the strong support for the establishment of a gas performance assurance regime, with all eleven respondents supporting one or both of the proposals. We agree with respondents and the UNC Panel that these proposals should be considered against relevant objectives (d) and (f). However, we additionally consider that they are relevant to objective (c) as set out below.

Whilst the extent to which market participants can be assured of the accuracy of gas allocation and settlements has been a longstanding issue for the industry, the implementation of new IT systems together with associated changes to UNC business rules as part of Project Nexus represent a potential step-change in those arrangements. In particular, for the first time Smaller Supply Points will be individually reconciled in much the same way that has traditionally benefitted Larger Supply Points, replacing the Reconciliation by Difference process, which allocates costs at an aggregated portfolio level, utilising Annual Quantity (AQ), determined by meter readings that are already at best several months old.

However, we have previously noted⁸ that Project Nexus will only remove the current systems constraints to improved settlements accuracy it does not of itself change the underlying rules on how frequently a shipper submits the meter reads necessary to trigger a reconciliation and revision to AQ. We therefore consider that such rules changes and the existence of a performance assurance regime may be required in order to realise the full benefits of Project Nexus, particularly with respect to:

- improving the timeliness of reconciliation; and

⁵ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.co.uk

⁶ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, available at: <https://epr.ofgem.gov.uk/Content/Documents/Standard%20Special%20Condition%20-%20PART%20A%20Consolidated%20-%20Current%20Version.pdf>

⁷ The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986 as amended.

⁸ See our decision letter on [UNC432](#)

- reducing the scale of the un-reconcilable Unidentified Gas (UG).

Whilst either UNC506V or UNC506AV would represent an important step towards the establishment of an effective performance assurance regime, further vital components are required to be in place in order for that framework to be effective. For instance, we note that UNC520 and the alternative UNC520A each seek to establish robust reporting in order to better inform the work of the PAC and/or PAFA. The PAC must also be appropriately empowered to incentivise appropriate powers and take remedial actions as and where required.

(c) efficient discharge of the licensee’s obligations

It was commonly accepted by respondents that a performance assurance regime is required in order to ensure the accuracy of gas settlements and that no unfair commercial advantage can be derived from settlement by any shipper. We agree with these views and, for the reasons set out below, consider that the introduction of a PAF will improve the efficiency of the gas market. Whilst gas shippers and gas suppliers will be the principle beneficiaries of these arrangements, we also note that GTs have obligations under their licence⁹ to conduct their business in such a way as to ensure that no gas shipper or gas supplier gains any unfair commercial advantage. They also have obligations under the Gas Act 1986 to facilitate competition in the supply of gas¹⁰. To the extent that the introduction of a PAF would remove, or at least mitigate, any unfair commercial advantage that may be gained from the current settlement arrangements and more generally will facilitate competition, we consider that either UNC506V or UNC506AV would further the efficient discharge of the GTs’ licence obligations in this respect.

(d) the securing of effective competition between relevant shippers and relevant suppliers

The accuracy of gas settlements is an important facilitator of effective competition. If costs are misallocated, this can lead to an unfair advantage for parties that have avoided those costs and reduce the advantage that should appropriately be gained by efficient operators. To the extent that market participants are not fully able to manage their exposure to settlement costs, it may even deter potential entrants. We consider that the introduction of a PAF would represent a substantive change in the approach to managing gas settlement accuracy, which will of itself provide greater confidence to market participants.

Although the focus of the work on performance assurance to date has been on settlements accuracy, we note and agree with the comments made in the FMR that the scope of the PAF may extend and bring wider consumers benefits. For instance, ensuring that targets for switching timescales are met, and improving (or at least maintaining) the standard of data quality would improve the efficiency of the change of supplier process. This will have wider benefits to competition by improving the consumer experience of switching. We therefore consider that either UNC506V or UNC506AV would better facilitate relevant objective (d).

(f) the promotion of efficiency in the implementation and administration of the Code

⁹ Standard Special Condition A6 (Conduct of transportation business)

¹⁰ Gas Act 1986 (as amended)(9)(1A)

Several respondents considered that UNC506AV would provide a more efficient means of delivering the PAF. Several suggested that they could not see a clear benefit for incurring the additional cost associated with engaging a third party to discharge the role of PAFA.

We agree that the PAFA role should be fulfilled in a cost efficient manner. Whilst some respondents consider that it would be most efficient for Xoserve to fulfil this role, there is no evidence to confirm that this would be the case. Xoserve has not produced a cost estimate and there has been no market testing.

We see no reason why the PAFA role could not be contestable, rather than a natural extension of Xoserve's de facto monopoly provision of gas central services. In the absence of any unique qualification and all else being equal, we consider it likely that competitive procurement would deliver a more efficient outcome. However, this should in no way preclude Xoserve from fulfilling the PAFA role, simply that it should be assessed against the same criteria as any other candidate.

Some GT respondents suggested that utilising Xoserve to conduct the procurement would be the only practical way for the GTs to recover the costs of the procurement exercise. This is on the basis that Xoserve would be able to recover any costs it incurs from the procurement exercise as a User Pays charge, to be levied upon shippers. They also went on to suggest that this issue could have been removed if shippers had been afforded the opportunity of arranging the tender directly.

We do not consider that the costs of conducting the procurement exercise will be material. Further, given that we consider the GTs are at least partially responsible for settlement accuracy, it is not clear that the costs of the procurement exercise should fall entirely to shippers, even if they were to be recovered as a User Pays charge. However, for the avoidance of doubt, we do agree that the operational and/or ongoing contractual costs of the PAF should be recovered from shippers only. We consider that the future shape of the PAF and the resource committed to its activities is unlikely to be disproportionate given the scale of the value at risk. For instance, the value of UG alone is consistently calculated to be in excess of £100m per year. Moreover, we consider that shippers themselves will be best placed to determine the appropriate amount of effort to expend in this area, such that even if levels of UG are considerably reduced, they will continue to seek assurance that the behaviours which led to this are maintained.

Whilst we accept that Xoserve has relevant experience of procuring third party services on behalf of market participants, these competencies are not unique to Xoserve and could be undertaken by the GTs directly. We agree that it may be preferable for the shippers themselves to have a lead role in the procurement. Whilst this may not be practicable under the current UNC arrangements, these inhibitions may change shortly, subject to the proposed Central Data Service Provider (CDSP) provisions and other funding and governance arrangements coming into effect.¹¹ In the meantime shippers could still play an important role in tender evaluation, in much the same way as they are with the procurement of a third-party allocation of UG expert under UNC473.¹²

¹¹ We recently consulted on modifications to the GT licence to introduce new Central Data Service Provider (CDSP) arrangements, further to our Funding Governance and Ownership (FGO) Review of Xoserve. This consultation closed 14 December 2015. See:

www.ofgem.gov.uk/sites/default/files/docs/consultation_on_changes_to_standard_special_condition_a15.pdf

¹² See: www.xoserve.com/index.php/modification-0473-project-nexus-allocation-of-unidentified-gas-aug/

Conclusion

Whilst we appreciate that UNC506AV may represent a simpler means of implementing the PAF, the industry has already invested in excess of three years in establishing these arrangements and we foresee no reason why they would not endure beyond the sunset date set out in that proposal. We also consider that while either proposal would further facilitate the relevant objectives of the UNC as compared with the status quo, the opportunity for a competitive procurement is significant and therefore consider that on balance UNC506V will be the more beneficial of the two proposals.

We consider that a competitive procurement process is the best means of ensuring value for money for the gas shippers who will be funding this service, but perhaps more importantly ensure that the gas industry is able to attract the best possible candidates and make a selection based on robust selection criteria. We would also welcome the evaluation panel being drawn from the widest possible range of stakeholders. For the avoidance of doubt, we do not consider that Xoserve should in any way be excluded as a potential candidate for the PAFA and our decision on these modification proposals is in no way an assessment of Xoserve's ability and qualifications to undertake such a role.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters licence, the Authority hereby directs that modification proposal UNC506V be made.

Angelita Bradney
Head of Smarter Markets

Signed on behalf of the Authority and authorised for that purpose