

Performance Assurance
Committee, Gas transporter
licence holders, gas shipper
licence holders, Joint Office, and
interested parties

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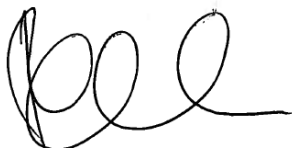
Gas Performance Assurance Framework: Remedy Implementation

The Competition and Markets Authority (CMA)'s energy market investigation concluded in June 2016 following a referral by Ofgem in 2014.¹ The CMA set out a package of remedies to address problems it found in the energy market. This letter is a notification of actions we have taken to implement the Gas Performance Assurance Framework (PAF) remedy.

The CMA concluded that the current system of gas settlement gives rise to Adverse Effects on Competition (AEC). They found that the inefficient allocation of costs to parties and the scope it creates for gaming reduces efficiency and competitiveness of domestic and micro businesses retail gas supply. One of the remedies the CMA proposed for this AEC is the PAF. The main objective of the PAF is to reduce the amount of unidentified gas. This is gas which cannot be directly attributed to the relevant gas shipper, requiring its cost to be socialised across the shipper community and generally resulting in gas settlement arrangements being less accurate.

The CMA recommended Ofgem take appropriate steps to ensure that a gas performance assurance framework is established within a year of the CMA's final report. The following sections of this letter set out the actions we have taken and how we intend to evaluate the effectiveness of the remedy.

Yours Faithfully



Rob Salter-Church
**Partner, Consumers and Competition
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¹ All documentation relating to the CMA's Energy Market Investigation can be found here:
<https://www.gov.uk/cma-cases/energy-market-investigation>

Gas Performance Assurance Framework

Background

Until smart meters are in place, domestic gas customers will not have their meter automatically read on a daily basis. Instead, a daily estimate of consumption is produced for these and other non-daily metered consumers. This daily estimate is derived from the Annual Quantity (AQ) for the supply point, itself calculated on the basis of consumption in previous years, and a profile of typical usage throughout the course of a year. The CMA considered that the relative inaccuracy of AQs and absence of reconciliation against actual reads do not provide the correct incentives to suppliers.

Project Nexus, the upgrade of the gas settlement IT system, went live on 1 June 2017.² The improvements to systems as a result of Project Nexus will address some of the AQ accuracy issues,³ however the CMA recognised that the incentives that shippers face to place a higher priority on adjusting AQs down and delaying adjusting AQs up may still be present after Project Nexus is implemented. It was also concerned that there would remain a residual amount of unidentified gas and inefficiencies in the allocation of its cost.

The CMA proposed that, amongst other things, a gas performance assurance framework would help make the gas settlement arrangements more accurate and support competition by improving cost allocation. It considered that the prevailing plans to establish a performance assurance framework were at the time not sufficiently advanced or provide confidence that a performance assurance framework would be delivered in a timely fashion.

It recommended that Ofgem take appropriate steps to ensure that a gas performance assurance framework is fully implemented by the end of June 2017.

Actions

A performance assurance workgroup under the Uniform Network Code had already completed a considerable amount of work in this area. We approved modification UNC506V⁴ in December 2015 that sought to establish a Performance Assurance Framework (PAF). The modification allowed for the establishment of a Performance Assurance Committee (PAC) as a sub-committee of the Uniform Network Code Committee (UNCC), and it specified that the PAC would be supported by a competitively procured PAF Administrator (PAFA).

The PAC held its inaugural meeting in June 2016.⁵ The Framework document that sets out the arrangements for the general administration of the PAF is available from the Joint Office website, alongside the agreed Terms of Reference of the PAC.⁶ With the appointment of a PAFA being made in June 2017, we consider that the substantive provisions are now in place for a credible PAF.

The PAC has published and is tracking against its implementation project plan. It is also reviewing the schedule 1 performance reports⁷ on a monthly basis.

² <https://www.ofgem.gov.uk/publications-and-updates/project-nexus-go-live-decision>

³ It will remove some of the system constraints that currently exist, for example, reconciliation can be at individual gas meter points rather than at an aggregated level through the Reconciliation by Difference process. It also provides the opportunity for independent gas transporters to use the same systems and processes as other gas transporters, and the potential for automated retrospective adjustment following meter readings

⁴ https://www.ofgem.gov.uk/sites/default/files/docs/unc506v_d.pdf

⁵ <https://www.gasgovernance.co.uk/PAC/290616>

⁶ <https://www.gasgovernance.co.uk/PAC>

⁷ These are the pre-nexus reports – a list of the reports are available from the Joint Office website: https://www.gasgovernance.co.uk/sites/default/files/ggf/PAC%20Document%201%20Performance%20Assurance%20Framework%20Report%20Register%20v1.0_0.pdf

We have engaged and tracked the progress of the PAC to assess whether additional action needed to be taken to fulfil the CMA's recommendations. The CMA recommended that Ofgem develop a work plan and consult on the appropriate incentives and remedies. We have collaborated with industry on the work plan, which was developed as part of the PAC discussions. The detailed PAC project plan is available from the gas governance website.⁸ Similarly, the PAC will be working with the PAFA to understand industry performance and review the main risks to gas settlement, both of which will inform the design of appropriate incentives and remedies. We expect the PAC to take an evidence-based approach when developing incentives. It is appropriate that the PAC first assesses performance in the post-Nexus environment so they can target incentives where improvements are required, and where they will have the greatest impact. However, we encourage the PAC to introduce incentive arrangements as quickly as possible, noting that any regime is likely to need to evolve over time.

The appointment of the PAFA and the PAC working towards delivering its project plan completes the establishment of the Performance Assurance Framework, and the implementation of the CMA remedy. It is appropriate that PAC leads the work in this area but we will continue to engage with the PAC as it develops options and consults on proposals.

Further industry-led work and outcomes

We are keen that the PAC is proactive when it has performance concerns, and the work on incentives and remedies, are consulted upon, and implemented in a timely manner. We expect that once the arrangements are in place that their effectiveness will be evidenced through a reduction in unidentified gas. We are supportive of PAC taking initiative to look into potential issues and risks to gas settlement as they arise. It was encouraging to observe the PAC proactively discussing and considering the issue of short-term volatility in unidentified gas estimates, which has emerged since Project Nexus has gone live.

Evaluation

In our implementation plan⁹ we set out that we will monitor and evaluate the effects of the remedies on a prioritised basis. The reviews of the remedies may include monitoring of outcomes (in this case levels of unidentified gas) and qualitative feedback from affected parties. The gas performance assurance remedy will be included in any review of the CMA remedies.

We have an observer role on the PAC and will attend as appropriate to ensure the gas performance assurance framework is effective. We believe the PAC should evolve over time and are supportive of industry considering modifications that will further support the PAC in achieving its objectives. The PAC must also be appropriately empowered to take remedial actions against individual shippers as and where required. If we become aware the PAC is not delivering and the incentives are not adequate we will then consider whether we need to take further action.

⁸ <https://www.gasgovernance.co.uk/PAC/131216>

⁹ <https://www.ofgem.gov.uk/publications-and-updates/cma-remedies-implementation-plan>