

ENERGY MARKET INVESTIGATION

Summary of responses to the consultations on the Draft Energy Market Investigation (Gas Settlement) Order 2016 and Draft Explanatory Note

Introduction

1. On 18 October 2016, the Competition and Markets Authority (CMA) consulted on a draft order (the Draft Order) and a draft explanatory note (the Draft Explanatory Note) for the implementation of the remedies set out in the energy market investigation final report (the Report).¹ The consultation closed on 18 November 2016.
2. In response to these consultations, the CMA received 16 submissions relating to the Draft Order and the Draft Explanatory Note. Non-confidential versions of the responses received are available on the CMA's webpages.² This paper sets out the main changes which have been made to the Draft Order as a result of those submissions. Minor changes (such as correction of typographical and spelling errors, minor clarifications included in the Explanatory Note, and other consequential changes) are not discussed in detail in this paper. References to specific Articles in this paper refer to the final version of the order published on the same date as this paper (the Order) rather than to any earlier drafts, unless stated otherwise. Capitalised terms in this paper have the same meaning as defined in the Order, unless otherwise specified below.
3. None of the modifications made to the Draft Order are considered to be material so as to require further consultation.
4. The two main comments received in response to the consultations related to
 - (a) the granularity of the information to be summited for the purpose of gas settlement, as set out in Article 3.4 of the Draft Order (the Daily-readings Requirement); and

¹ [Energy market investigation: Final report.](#)

² [Energy market investigation case page.](#)

- (b) the frequency of the information to be submitted for the purpose of gas settlement as set out in Article 3.3 of the Draft Order (the Monthly-submission Requirement).

Granularity of the information to be submitted for the purpose of gas settlement: the Daily-readings Requirement

5. The thrust of parties' responses focussed on the requirement set out in Article 3.4 of the Draft Order (and in the new paragraph 21B.4A of the Gas Supply Licence set out in Schedule 1 to the Draft Order).
6. This Article introduced a requirement for Retail Gas Suppliers to take all reasonable steps to obtain 'Valid Meter Readings' for every day from each of its Customers with a Supply Meter able to remotely transmit meter readings. These daily meter readings in turn would be submitted, in batches, at least once a month (pursuant to the Monthly-submission Requirement set out in Article 3.3). This in practice would have the effect to mandate the use of Product 3 under Project Nexus, as defined in the UNC.
7. The CMA considers that there are clear benefits associated with the monthly submission of batches of daily meter readings, over and above the monthly submission of one (monthly) meter reading.
8. The requirement to submit a monthly meter reading will facilitate the rolling (monthly) revision of annual quantities³ (AQs) and address the gaming opportunities in the current annual review process which contribute to the Gas Settlement AEC, but will fail to realise the full benefits that can be obtained from smart meters. A major plank of the Government's cost-benefit assessment for the £11 billion roll-out of smart meters is that consumers will be prompted to reduce their energy consumption when presented with additional information about their actual usage. However, even with the monthly submission of monthly meter readings, it may be around fourteen months before any substantive change in energy consumption (for instance a change due to customers' response to information provided by smart meters) is fully reflected in the applicable AQ. In the meantime, relevant shippers would receive initial over-allocation of Non-Daily Metered (NDM) gas demand.
9. Currently, a profile which takes into account typical usage patterns throughout the year is used for the purpose of gas settlement. Therefore it is an estimate of annual consumption represented by the AQ that is utilised for the allocation of gas each day. A single profile is used for the vast majority of Smaller

³ See paragraph 9.517 of the Report.

Supply Points⁴. Despite the significant efforts that go into producing these profiles, the CMA is aware of Xoserve's analysis which suggests that the current 01B profile⁵ (which typically applies to domestic supply points) results in an under allocation of gas in winter, and an over allocation in summer.⁶

10. Notwithstanding these systemic issues, profiles are only an approximation of consumption at each relevant supply point, with the actual consumption at most premises falling either side of that average to a greater or lesser extent. The CMA has not conducted analysis to determine to what extent the population is accurately represented by the current profiles that are used, but considers that in any case customers' consumption patterns are likely to change with the advent of smart metering and the additional signals mentioned above.
11. Any error in NDM gas allocation will initially impact upon the calculation of Unidentified Gas (UG), which will act as the balancing factor for gas allocation post-implementation of Project Nexus. Therefore, UG could be a positive or negative value, being the remainder of total Local Distribution Zones⁷ throughput once Daily Metered (DM) measurements and NDM estimates (and an allowance for calculated shrinkage) have been subtracted. The CMA accepts that gas allocation will always contain a degree of error as it is based on forecast usage, but these errors should be more adequately addressed by the subsequent reconciliation arrangements.
12. The CMA acknowledges the points made by several respondents that Project Nexus will replace the current 'Reconciliation by Difference' process (see paragraph 9.518 of the Report) with individual supply point reconciliation based on actual meter readings. The mandated submission of annual readings from all supply points (Article 4 of the Order) should ensure that no consumption is *timed out* from being reconciled by the UNC cut off period of 3 to 4 years. Further, the requirement to submit monthly readings should ensure that any error in the initial gas allocation is relatively quickly reconciled, reducing the amount of UG needing to be shared across the industry. However, whilst these arrangements may serve to increase the accuracy of the reconciliation of the gas volumes allocated to each supply point, their imprecise nature means that the relevant shippers are not fully exposed to, nor able to manage, the costs associated with those reconciled volumes.

⁴ As defined in the Transportation Principal Document of the UNC, and includes domestic customers and some SMEs in respect of which the Annual Quantity is not greater than 73,200 kWh.

⁵ That is the profile applied to supply points with AQs below 73,200 kWh. See Xoserve, 15 January 2014 [Technical Work Group, Review of EUC Definitions](#).

⁶ See 15 November 2016 [Demand Estimation Sub-Committee minutes](#).

⁷ As defined in the Transportation Principal Document of the UNC.

13. The CMA considers that this issue is likely to be material. Whilst gas prices may not be as volatile as electricity prices, there are still considerable fluctuations, even to the System Average Price⁸ (SAP) within a given month. Over the past three years, the average spread between highest and lowest SAP value within a calendar month has been around 25%.⁹ Whilst a monthly meter reading will demonstrate the volume of gas that has been consumed over the course of a month it cannot show on which days it was consumed. Instead, it will be allocated across the full month using the same profile as mentioned above. Any difference between actual daily consumption and the profiled daily allocation will result in the shipper paying an incorrect value for the differential volume and distort residual UG for each day. The impact of profiling errors on reconciliation could be avoided and all gas volumes settled at their true value if each gas day was reconciled using the relevant daily meter reading. Some parties acknowledged this may be the case but generally challenged whether such benefits would outweigh the additional cost. Whilst the CMA remains convinced that increased accuracy in the settlement process would lead to material benefits, the CMA accepts that there is still uncertainty in relation to the quantification of such benefits.
14. Several Retail Gas Suppliers also told us that, in their Project Nexus design, they have not built IT capabilities to accommodate Product 3 and that, as a result, significant additional resources would be required in order to update relevant IT systems for the purpose of complying with Article 3.4 of the Draft Order.
15. In their representations, some Retail Gas Suppliers estimated that the cost of building this additional piece of IT infrastructure would be in the order of a few million pounds. Also there was concern with the timescale of implementation. Several respondents voiced concern in relation to the ability of the industry as a whole, and Xoserve in a particular, to deal with this requirement shortly after implementation of Project Nexus.
16. The CMA accepts that, where suppliers have not already built in their IT systems the capabilities required for Product 3, the cost of building such additional capabilities in the course of 2017 would be material (although the CMA has not been able to establish if this would indeed amount to a few million pounds for certain suppliers).

⁸ As defined in the Transportation Principal Document of the UNC

⁹ Source: SAP applicable for 1/10/13 to 30/09/16 – [National Grid](#).

Frequency of the information to be submitted for the purpose of gas settlement: the Monthly-submission Requirement

17. Some parties argued that, because of the significant challenges raised by the implementation of Project Nexus, IT infrastructures would be under significant pressure for a certain period of time starting on Project Nexus Implementation Date, until Project Nexus's IT system became stable. They noted that at this stage it is not possible to say precisely how long this period of instability would last. They noted however that additional pressure would add to the level of risk and, therefore, that the implementation date set out in Article 1.2 of the Draft Order with respect to the Monthly-submission Requirement (ie Project Nexus Implementation Date), introduced unnecessary risk to the implementation of Project Nexus.

Alternative approach to implementation

18. In light of the uncertainty about the quantification of costs and benefits of the specific requirement set out in Article 3.4 of the Draft Order, and the risk noted above in paragraph 17, the CMA has decided to adopt a more conservative approach for implementing the remedy that remains consistent with the remedy set out in the Report.
19. The CMA discussed an alternative implementation strategy with Ofgem. In addition, it attended a call with Ofgem and the industry trade body Energy UK (with representatives of the Six Large Energy Firms¹⁰ and some independent suppliers attending) on 6 December 2016. On this call, representatives of the industry suggested to Ofgem and the CMA that:
 - (a) an impact assessment of the implementation of the Daily-readings Requirement could be carried out by the industry in early 2017 within the context of the UNC modification proposal UNC594R, with support from Ofgem;
 - (b) the implementation date for the Monthly-submission Requirement set out in the Article 3 of the Order should not be set before it is confirmed that Project Nexus has been successfully implemented and is "stable";
 - (c) if the impact assessment for the Daily-readings Requirement was positive, a suitable implementation date would be identified; in this scenario it was noted that there would be benefits in aligning the IT projects relating to the frequency of submissions (for the Monthly-submission Requirement set

¹⁰ Centrica plc, EDF Energy plc, E.ON UK plc, RWE npower plc, Scottish and Southern Energy plc and Scottish Power.

out in the Order) and to the granularity of the information to be submitted (for the Daily-readings Requirement).

20. The CMA also notes that Ofgem intends to publish in the next few days a document setting out steps it intends to take so as to support the implementation of this Order, notably to ensure that an impact assessment of the Daily-readings Requirement is completed by July 2017 (either within the context of UNC594R or following an initiative taken by Ofgem).
21. In light of the above, the CMA has decided to remove the Daily-readings Requirement from the Order (including from the amendment to the Gas Licence Condition). It has also amended Article 1.2 so that the Monthly-submission Requirement will enter into force by 1 April 2018. In addition, Article 1.2 provides that the CMA may direct a later date for implementation of the Daily-readings Requirement. The CMA may choose to do so for instance if the impact assessment for the Daily-readings Requirement is positive but shows that such requirement should not be implemented before, say, 1 October 2018. In such a case the CMA would consider whether it is appropriate to align the implementation of the Daily-readings Requirement and Monthly-submission Requirement.
22. Article 1.2 further provides that the CMA shall make such a decision no later than 1 September 2017. By that date, the outcome of the impact assessment and of the implementation of Project Nexus should be sufficiently clear. However, if by 1 September 2017 either the impact assessment has not been concluded (or does not set out a positive case for proceeding with the Daily-readings Requirement), or Project Nexus has not been implemented, or both, the CMA would not propose to issue a direction that postpones the implementation of the Monthly-submission Requirement.