

Representation - Workgroup Report

UNC 0642 (Urgent) 0642A (Urgent) - Changes to settlement regime to address Unidentified Gas issues

UNC 0643 (Urgent) - Changes to settlement regime to address Unidentified Gas issues including retrospective correction

Responses invited by: **5pm on 08 February 2018**

To: enquiries@gasgovernance.co.uk

Representative:	Richard Pomroy
Organisation:	Wales & West Utilities
Date of Representation:	8 th February 2018
Support or oppose implementation?	0642 - Oppose 0642A - Oppose 0643 – Oppose
Alternate preference:	<i>If either 0642, 0642A or 0643 were to be implemented, which would be your preference?</i>
Relevant Objective:	d) None 0642 0643 0642A f) Negative 0642 0643 0642A

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

We oppose all three proposals for the reasons given below. We go into more detail on each point in the Additional Information section.

1. 0643 is retrospective and we do not believe that it meets any of the Ofgem criteria for retrospective changes. The implementation date proposed for 0642 would make it retrospective when implemented and we oppose this, we cover this in the implementation section.
2. There is a significant risk of unintended or unexpected consequences due to insufficient analysis of the proposals due to the accelerated timescales. The whole industry developed the Nexus changes and agreed the new arrangements

- for UIG and it should have been clear that Large Supply Point Shippers would be exposed to this.
3. The current arrangements that expose UIG have led to action on DM reads, AOs set to 1 and Winter Average Ratios that probably would not have occurred under previous arrangements and there is a risk that these benefits would be lost under these proposals.
 4. We think that the statement in 0642 and 0643 that Shipper costs have increased by £18M **each** month are incorrect and it is more likely to be a redistribution of working capital requirements from Small Supply Point Shippers to Large Supply Point Shippers.
 5. These modifications seek to distinguish between NDM profile error and long term unidentified gas; however they do not define the concepts and hence will not resolve any issues. They will just transfer the debate about the correct figure for long term unidentified gas to either the Allocation of Unidentified Gas Expert (0642 and 0643) or the Demand Estimation sub-committee (0642A).
 6. There is clearly a need to develop better NDM profiles and we would be better pursuing this under 0631R and 0644 than spending significant resource on implementing one of these proposals.

Implementation: *What lead-time do you wish to see prior to implementation and why?*

We believe that the implementation date should be set in consultation with the industry once a realistic date is known for the implementation of system changes following detailed analysis of the design build and testing of the system changes that are required.

Notwithstanding that 0643 is retrospective; the proposed implementation date is consistent with the above view as is 0642A.

0642 is not, in itself, retrospective in that, unlike 0643, it does not require recalculation of settlements back to 1st June 2017. That stated, by specifying an implementation date before the system changes are implemented, there will be a significant period of up to a year that will be settled using the current arrangements but which will then be re-calculated when the system changes are implemented. We believe that this will result in considerable uncertainty for Shippers and we note that concern over uncertainty is one of the reasons for the proposer raising a change. The proposer's timescale will result in implementation at best, one month after an Ofgem direction to implement. This will mean that industry parties will have very limited time to change their processes from their current (post Nexus) arrangements to the proposed arrangements. We therefore do not support the proposed implementation dates for 0642.

We also note the issue of any transition arrangements has not been discussed for any of the proposals nor has any requirement for Non Effective Days to assist with any implementation. Should any of the modifications be implemented we would expect the proposer to take on the responsibility for the timely raising of any further modifications necessary to achieve the smooth implementation of the modification.

Impacts and Costs: *What analysis, development and ongoing costs would you face?*

We do not expect to face any direct costs.

Legal Text: *Are you satisfied that the legal text will deliver the intent of the Solution?*

Yes. We would like to record our thanks to Cadent, for managing, and to Dentons, for producing, the legal text to the required deadline.

Are there any errors or omissions in this Workgroup Report that you think should be taken into account? *Include details of any impacts/costs to your organisation that are directly related to this.*

The report delivers the requirements of a workgroup report. Owing to the timescale imposed the workgroup had to focus on delivering the report and was not able to explore the wider implications of the proposals.

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

The points below provide for detail in support of our opposition to all three modification proposals.

1) Retrospective elements of 0643 do not pass Ofgem test

The Ofgem guidance on retrospective changes lists the following three issues that may justify retrospective modifications:

- 1) a situation where the fault or error giving rise to additional costs or losses was directly attributable to central arrangements;
- 2) combinations of circumstances that could not have been reasonably foreseen;
- 3) or where the possibility of a retrospective action had been clearly flagged to the participants in advance, allowing the detail and process of the change to be finalised with retrospective effect.

Point 3 clearly does not apply. Point 1 does not apply as there was no fault or error - the central systems work as designed. Point 2 is the only one which could apply but in this case we understand that at least some Shippers did foresee the impact of the changes. As the test is whether the circumstances could have been reasonably foreseen not whether actions had been taken in preparation for the changes we suggest that the test has not been passed. We recognise that the changes required may have included changes in business process as well as changes in the way contracts with customers were priced and changes in contractual arrangements all of which may have needed some time to implement.

WWU therefore believes that 0643 does not satisfy the test for a retrospective change.

2) Risk of unintended and unforeseen consequences

The whole industry spent about seven years developing the project Nexus arrangements and it is extremely unwise to abandon a significant part of this without careful consideration and analysis of whether the changes will provide a benefit. The proposer of 0642 previously noted that the exclusion of DM Supply Points from the proposals and the re-allocation of the reconciled volume to the current month only were introduced to reduce the work required to implement the proposals. By implication this is acknowledged to be a sub-optimal solution. It is possible that this will lead to the following:

- a) A flight to DM. That is Shippers nominate Supply Meter Points to Class 2 to provide certainty by avoiding the reallocation of reconciled volume (be it positive or negative) even though the meters are incapable of providing automated daily reads. There is no cost to this as there are no consequences if reads are not provided each day and in addition to the certainty benefit there is a benefit from reduced UIG allocation to Class 2 compared to Classes 3 and 4. We note that the current arrangements already provide an incentive to migrate Class 2 due to the lower UIG allocated to Class 2 by the AUGE and the lack of any consequences from not providing reads.
- b) We suspect that if Shippers do not read meters each month there may be opportunities to game as to when meter reads are submitted.
- c) The proposal contains a concept of a threshold such that if the volume to be reallocated exceeds the total volume allocated to Supply Meter Points that are unread in that month then the volume to be reallocated will be spread over all Supply Meter Points rather than the unread Supply Meter Points. Our understanding is that Shippers will not know when the threshold will be passed and therefore they may unexpectedly see a re-allocation of volume to a Supply Meter Point even when it has been read in that month.

3) Visibility of UIG has led to action being taken on industry issues

DM reads, AQs being set at 1 and NDM Winter Average Ratio bands have been or are being looked arguably at as a result of the visibility of UIG. Under the pre-Nexus arrangements these issues were hidden and borne by SSP Shippers and there was no incentive on other parties to address the issues that they caused. Since the modifications have been developed on limited timescales the extent to which they would or would not incentivise Shippers to address issues is not clear. We think that the changes proposed may tend to mask issues. Therefore the proposers have not demonstrated that changing from current arrangements is beneficial.

4) Cost redistribution rather than an additional cost

0642 and 0643 assert that there is monthly cost to Shippers of £18M. Given that no more gas is being put into the System we believe that this is cost redistribution rather than an increase in total cost.

It seems likely that this is a movement of cost from Small Supply Point Shippers to Large Supply Point Shippers (both NDM and DM). For those Shippers seeing an increase in cost we think that it is more likely to be an increase in working capital which, for any one month, will be resolved as reconciliation of meter reads occurs. If this is correct we would expect that the working capital requirements will stabilise after a year and not continue to increase.

It may be that some Shippers can finance working capital requirements more cheaply than others but the proposals do not provide any evidence on this matter so we cannot comment on this. Notwithstanding this lack of evidence this is a cost of doing business. To put this working capital increase in perspective it is worth noting that WWU has experienced a working capital impact of approximately £2M a month for 2 years (total £48M) as a result of increases in NTS exit capacity charges. WWU's revenue is about £420M a year. We assume that Ofgem will be consistent in its assessment of the materiality of working capital impacts resulting from industry arrangements.

5) Proposals do not address issues just move them

We understand the desire to prevent DM Supply Meter Points volumes being adjusted as NDM Supply Meter Points are reconciled but if this is to be achieved the concept of long term unidentified gas needs to be clearly and unambiguously defined. 0642 and 0643 state a value for long term unidentified gas, with any other error being apportioned to certain Supply Meter Points in that month; 642A states a different value and also has a concept of a Balancing Quantity to reflect NDM profile error. In all the modifications the two errors are shared differently between Supply Meter Points and hence Shippers. As the values are commercially significant there will always be contention unless we can agree an unambiguous way to determine these errors. Unfortunately none of the proposals achieve this. They assert different initial values for long term unidentified gas then pass the responsibility for determining this on an on-going basis to another industry body; either the Allocation of Unidentified Gas Expert (0642 and 0643) or the Demand Estimation sub-committee (0642A). In our view this does not solve any problem it just moves the debate about UIG to another body. None of these modifications will achieve a resolution and we run the risk of further changes being raised to further amend the calculations.

6) Need to improve NDM algorithms

There is clearly a need to improve the NDM algorithms, if these provided more accurate allocations then many of the issues would disappear. The fact that the NDM algorithms are not accurate under some conditions is well known to attendees at Demand Estimation sub-committee meetings and the visibility of UIG has brought this into general view (see point 3 above). Our view is that we should continue with the current arrangements and that the resources required to implement one of these modifications would be better spent on 0631R and 0644 which seek to improve the NDM algorithms.