

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

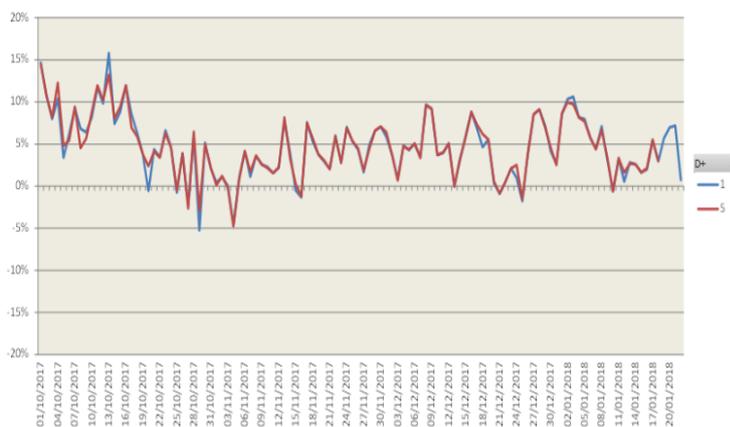
Responses invited by: **5pm on 08 February 2018**

To: enquiries@gasgovernance.co.uk

Representative:	Gareth Evans
Organisation:	ICoSS – the response represents the views of the majority of the members.
Date of Representation:	8 February 2018
Support or oppose implementation?	0642 - Support 0642A - Oppose 0643 - Support
Alternate preference:	<i>If either 0642, 0642A or 0643 were to be implemented, which would be your preference?</i> 0643
Relevant Objective:	d) Positive (0642/0643), Negative (0642A)

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

UNC Modifications 0642 & 0643 were raised to address the unpredictable and volatile nature of UIG, which was significantly more than we anticipated prior to Nexus go-live and represented a threat to the market's competitiveness. We note that the volatility of UIG has not noticeably diminished since this modification was raised, and is still of the order of over £10m a month. As highlighted by the AUGÉ (DNV GL) in October 2017, the range of Unidentified Gas levels being experienced by individual shippers is much higher with most seeing uncorrected demand increases (volatility) to their portfolios between -20% and +25% at an individual LDZ. We anticipate that it will continue at this same level for the foreseeable future as set out by Xoserve's data:



A solution is therefore needed that will address this issue. In this response we assess the relevant modifications as to whether they achieve this aim.

UNC Modification 0642

This modification has a positive impact on relevant objective (d).

This modification achieves the goal of addressing the current issues regarding the scale and unpredictability of Unidentified Gas (UIG). Reinstating the balancing regime to the D+5 stage that existed prior to Project Nexus, will bring settlement volatility back to levels that existed before 1 June 2017. This will ensure a liquid and competitive market will continue to exist.

The proposed reconciliation regime will also further competition by targeting settlement error at those sites that cause it, namely non-daily metered sites that are unread. Though, in order to ensure a solution is delivered quickly the modification has had to compress reconciliation timescales from 12 months to 1 month, targeting settlement error costs at those sites that cause it will incentivise competition and promote more frequent read submission, further reducing UIG volatility.

UNC Modification 0642A

This modification has a negative impact on relevant objective (d).

This modification effectively represents a return to the process prior to the AUGE where system losses are smeared uniformly across all shippers (with the limited exception of the very largest sites). This is a retrograde step akin to the reintroduction of the RbD process. If this occurs we expect that the industry will lose all incentive to tackle the sources of Unidentified Gas that currently exist as there will no benefit to any shipper to reduce its values; it will simply be a uniform pass-through cost such as transportation charges. It also shifts settlement error from those customers that are most weather-sensitive (domestic customers) and so most likely to create variation in demand to customers that are less so.

This shift in UIG allocation also generates a windfall profit to large domestic suppliers. This is due to the fact that this modification shifts UIG from domestic suppliers to non-domestic, going against the work undertaken by the AUGE which has consistently identified that the majority of Unidentified Gas originates from the smaller supply point market. This is indicated below:

	AUGE Factors UIG %				
EUC	CI 1 AUGE	CI 2 AUGE	CI 3 AUGE	CI 4 AUGE	Mod 642A
01B	0.005%	1.35%	1.36%	2.89%	2.50%
02B	0.005%	1.33%	1.33%	2.99%	2.50%
03B	0.005%	1.37%	1.37%	2.96%	2.50%
04B	0.005%	1.42%	1.31%	1.40%	2.50%
05B	0.005%	1.42%	1.43%	1.53%	2.50%
06B	0.005%	1.31%	1.32%	1.40%	2.50%
07B	0.005%	1.04%	1.06%	1.02%	2.50%
08B	0.005%	0.57%	0.57%	0.48%	2.50%
09B	0.005%	0.005%	0.005%	0.005%	0.01%

Finally this modification does not address the issue regarding UIG volatility. The modification proposes a Balancing Quantity which simply replicates the current smearing process of UIG, being both unpredictable and highly volatile.

UNC Modification 0643

This modification has a positive impact on relevant objective (d).

There are many similarities between UNC Modification 0642 and 0643. Like UNC Modification 0642, this modification will address the current issues regarding the scale and unpredictability of Unidentified Gas (UIG) by reinstating the pre-nexus balancing regime. It will also incentivise read submission by targeting settlement error losses to unread sites. This modification goes further however in its solution by maintaining the current 12 month timescale for reconciliation periods, tracking read performance month by month. In addition it also includes daily metered sites in the settlement regime. These differences create a more robust solution and so this modification furthers the relevant objective more than UNC Modification 0642.

This modification also proposes retrospective corrections to Unidentified Gas allocations between 1 June 2017 and the implementation date. This is appropriate as the majority of existing market contracts were set on the basis that UIG costs would not significantly increase. Re-aligning the current regime to the new settlement processes will not therefore have a significant detrimental impact on the market as it will simply remove windfall gains and losses from industry parties. We therefore do not believe that the retrospective process will be detrimental to industry competition.

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

Xoserve has indicated that both UNC Modifications 0642 and 0643 have a significant lead-time for development and implementation. In order to facilitate early delivery, we

would expect that Xoserve will re-examine the significant time put aside for such testing to ensure that the delay to delivery is minimised.

We agree with the proposers of UNC Modification 0642 that change is urgently needed to avoid long-term and irreversible damage to the market as smaller suppliers are driven out of the market. We note the challenges raised by Xoserve regarding the ambitious timetable proposed in this modification, but believe that once the modification has been approved, the market will have an understanding of the settlement framework and so will be able to operate to it as systems are aligned. The changes to the UNC and the system can therefore be progressed at different speeds and so we believe a spring/summer 2018 implementation date for UNC Modification 0642 is achievable.

With regard to UNC Modification 0643, there is a retrospective element included which on the face of it will allow implementation at any time as the solution will be backdated. Despite this ostensible flexibility in reality the solution needs to be implemented as soon as possible to give certainty to the market on the rules that will be followed.

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

UNC Modifications 0642 & 0643

Operationally, both of these modifications will remove the large and unpredictable volume of Unidentified Gas currently present in the wholesale market, substantially reducing our member's balancing. We do anticipate a slight increase in operational costs as our members are incentivised to submit reads each month for all their sites, but believe these costs will be offset by the ability to manage UIG costs through providing such reads.

In terms of development costs, implementation of these modifications will require a reinstatement of our members' nomination and forecasting processes that were utilised prior to Project Nexus go-live. This is a reversion to the previous regime which our members will be familiar with, so we anticipate that the costs to do so will not be significant. By reverting back to the previous regime it also removes the requirement to revisit existing contracts with non-domestic customers.

We do not believe that members will incur a significant cost from handling any retrospective calculations as proposed under UNC Modification 0643. The retrospective calculation simply aligns the market with risk premia priced into existing contracts and so no additional costs will be incurred.

UNC Modification 0642A

This modification will represent a significant change to our member's current operational framework as it implements a new regime of applying an effective uniform smear of Unidentified Gas across all customers, except the very largest. This will result in additional gas being allocated to medium and larger I&C customers. This will mean that the entire pricing basis of the majority of our members' contract with their customers will have to be re-evaluated as they have not been priced on the basis of a uniform pass-through of Unidentified Gas.

Longer term we expect that there will be additional costs incurred by smaller and non-domestic shippers in having to handle increased volumes of Unidentified Gas being assigned to them compared to present.

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

The legal text for UNC Modifications 0642 and UNC Modification 0643 deliver the solution as intended. We have not reviewed the legal text of UNC Modification 0642A.

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.*

No.

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

NA