

Modification proposal:	<b>Uniform Network Code (UNC) 507: Changing the effective date of 451AV (Individual Settlements For Pre-Payment &amp; Smart Meters)</b>		
Decision:	The Authority <sup>1</sup> has decided to accept UNC507 <sup>2</sup>		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	23 October 2014	Implementation date:	1 November 2014

## Background to the modification proposals

The majority of gas meters are not read on a daily basis, with consumption being estimated based on the prevailing Annual Quantity (AQ) of the supply point. In order to break these AQs down into a daily estimate for gas allocation and subsequent invoicing, a profile is applied to the AQ, based on the typical consumption pattern throughout the year. A single profile applies to all Smaller Supply Points within each Local Distribution Zone (LDZ).

On 31 January 2014 the Authority directed the implementation of UNC451AV<sup>3</sup>, which introduced the concept of a bespoke profile for pre-payment meter (PPM) customers. In taking our decision, we agreed with the evidence provided that the consumption profile of a PPM customer is flatter through the course of a year than that of a standard (typically domestic credit) customer. This may result in the over-allocation of gas during the winter months. Whilst in energy terms this over-allocation will be offset by a corresponding under-allocation in summer, the relevant shipper may be exposed to increased costs as System Average Prices for wholesale gas are typically higher during the winter months.

Acknowledging the potential impacts of this over allocation of costs, in April 2013 we agreed that the original UNC451 proposal<sup>4</sup> should follow urgent modification procedures<sup>5</sup>. This urgent status continued to apply to its subsequent variant UNC451V and the alternative proposal UNC451AV. It was also acknowledged that the proposed PPM profiles for each LDZ would not be available immediately upon receipt of an Authority decision, and that further work would be required on both those and the associated systems before any invoice adjustments to reconcile the difference between the two profiles could take place.

UNC451V proposed that these adjustments be backdated to 1 October 2012, whereas the alternative UNC451AV sought a prospective only adjustment, to be effective from a date which followed a decision to implement the PPM profile.

UNC451AV was implemented with effect 1 February 2014.

## The modification proposal

UNC507 seeks to change the effective date of UNC451AV from 1 February 2014 to 1 October 2014. This would exclude those eight months from 1 February 2014 through to 30 September 2014 from reconciliation between the two profiles. The proposer considers that this would ensure that the adjustment is applicable only to a complete Gas Year. Noting that the PPM profile for each LDZ has not yet been finalised, the proposer also considers

<sup>1</sup> The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of Gas and Electricity Markets.

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

<sup>3</sup> See: <http://www.gasgovernance.co.uk/0507>

<sup>4</sup> UNC451 originally sought to allow any supply point with a PPM that has had a read accepted in any given month to be reconciled against that read, effectively excluding that supply point from the prevailing Reconciliation by Difference mechanism. During the development of UNC451 it became apparent that it would not be practicable to introduce such individual meter point reconciliation for Smaller Supply Points ahead of Project Nexus systems changes being implemented. The proposal was therefore substantively varied, such that PPM supply points would instead be reconciled against a bespoke profile, and re-numbered UNC451V.

<sup>5</sup> See: [http://www.gasgovernance.co.uk/sites/default/files/UNC451\\_UD.pdf](http://www.gasgovernance.co.uk/sites/default/files/UNC451_UD.pdf)

that the implementation of UNC507 would reduce uncertainty over the extent to which shippers' will be exposed to adjusted charges.

UNC507 also seeks to ensure that if the PPM profile is not delivered by 1 January 2015, there will be no reconciliation under UNC451AV.

### **UNC Panel<sup>6</sup> recommendation**

At its meeting of 18 September 2014 the UNC Panel voted by a majority to recommend that UNC507 is not implemented.

### **The Authority's decision**

The Authority has considered its statutory duties and functions in reaching its decision. The Authority has considered the issues raised by the modification proposal and the FMR dated 18 September 2014. The Authority has considered and taken into account the responses to the Joint Office's consultation on the modification proposal, which are attached to the FMR<sup>7</sup>. The Authority has concluded that:

1. Implementation of UNC507 will better facilitate the achievement of the relevant objectives of the UNC<sup>8</sup>; and
2. Directing that the UNC507 be made is consistent with the Authority's principal objective and statutory duties<sup>9</sup>.

### **Reasons for Authority decision**

We note that in addition to the three responses to UNC507 referenced in the FMR, a further two late responses were received. We have considered the views expressed by all five respondents.

The proposer and one of the late respondents considered that the implementation of UNC507 would further relevant objective d), while the three other respondents felt that no evidence of such benefits had been provided. Those respondents also felt that implementing UNC507 would be detrimental to relevant objective f). We agree that UNC507 should be assessed against these two relevant objectives and that it would be neutral in respect of the others.

### ***Relevant Objective (d) securing effective competition between relevant Shippers***

We accepted UNC451AV on the basis that it would improve the accuracy of cost allocation and therefore further effective competition. However, we noted that the net effect would be largely subject to prevailing weather conditions and System Average Price. We also noted that UNC451AV was intended to be an interim measure pending the substantive improvements to gas allocation and settlements due to be implemented as part of Project Nexus<sup>10</sup>.

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<sup>6</sup> The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

<sup>7</sup> UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at [www.gasgovernance.com](http://www.gasgovernance.com)

<sup>8</sup> As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: <https://epr.ofgem.gov.uk/Content/Documents/Standard%20Special%20Condition%20-%20PART%20A%20Consolidated%20-%20Current%20Version.pdf>

<sup>9</sup> 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.

<sup>10</sup> Project Nexus aims to ensure that the systems operated by Xoserve that underpin the competitive gas market meet the current and anticipated business requirements of participants in that market.

Under normal seasonal conditions, both the existing profile and the proposed PPM profile would result in the same aggregate allocation of gas over the course of a full year, i.e. both would match the prevailing AQ. However, on any given day there would be a variance in energy allocation between the two profiles, which would be reflected in a profile based monthly energy invoice. Under normal seasonal conditions, the total amount of energy invoiced under the two profiles will only match at the end of each twelve month period.

#### Distribution of cost

Typically, modifications such as UNC451AV would be implemented at the start of a Gas Year or financial year. We granted the original UNC451 proposal urgent status<sup>11</sup> in order to facilitate it being in a position to be decided upon and, if appropriate, implemented ahead of the 2013/14 Gas Year. However, when the Final Modification Report (FMR) was submitted to us on 19 September 2013 we identified deficiencies in the legal text which led us to conclude that we were not in a position to properly decide upon the proposals. We therefore sent the FMR back to the UNC Panel<sup>12</sup> for revision. The revised FMR was submitted to us on 17 January 2014.

Following our decision on 31 January 2014 to accept UNC451AV, it was implemented the following day, giving immediate effect to the modified business rules, notwithstanding that the final PPM profiles and associated systems would follow in due course. 1 February 2014 was therefore the earliest practicable implementation date and was consistent with the continuing urgent status of the proposal.

As noted in our decision on UNC451AV, any reduction in gas allocation to PPM supply points will be offset by an increase to the supply points remaining on the standard profile (and vice versa). However, to the extent that this redistribution reflects a more accurate allocation of costs we consider that it is beneficial to effective competition. In order to ensure this accuracy, it is important that the redistribution works in an equitable manner and is not artificially distorted.

If the proposed PPM profiles were to apply on an enduring basis, there would be little or no distortion arising from the implementation date of UNC451AV, as the seasonal distribution would be fully netted off with each 12 month cycle. While we anticipated the future introduction of Project Nexus, at the time of taking our decision on UNC451AV a firm implementation date was in effect and under the UNC rules extant at the time, the new PPM profiles may have applied on an enduring basis.

However, subsequent to the implementation of UNC451AV, the Authority accepted UNC432<sup>13</sup>, which amongst other things codified the Project Nexus implementation date as 1 October 2015. UNC432 also introduced four new settlement products<sup>14</sup>, each of which provide for the individual reconciliation of supply points and therefore fulfil the intent of UNC451 as originally drafted. The UNC432 legal text will, upon implementation, overwrite and modify much of the prevailing UNC. This will include the removal of text inserted by UNC451AV, thus giving that modification an effective end date.

As currently set out in the UNC, the invoice adjustments given effect by UNC451AV would apply only to the 12 summer (April – September) months and 8 winter months from 1 February 2013 to 30 September 2015. This asymmetry would have a distortive effect on

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<sup>11</sup> See: [www.gasgovernance.co.uk/sites/default/files/UNC451\\_UD.pdf](http://www.gasgovernance.co.uk/sites/default/files/UNC451_UD.pdf)

<sup>12</sup> See: [www.gasgovernance.co.uk/sites/default/files/UNC451%20send%20back\\_icl%20\(4\).pdf](http://www.gasgovernance.co.uk/sites/default/files/UNC451%20send%20back_icl%20(4).pdf)

<sup>13</sup> UNC432: 'Project Nexus - Gas Demand Estimation, Allocation, Settlement and Reconciliation reform'

<sup>14</sup> In summary, the four Project Nexus settlement products are:

- Product 1 – DM. Time critical, with reads required by 10am. This is mandatory for supply points with an AQ above 58.6MWh only
- Product 2 – 'DM-lite', submission of reads is not time critical and can be submitted at any time of day.
- Product 3 – daily readings submitted in batches.
- Product 4 – periodic meter readings, with existing standards for read submission and timing.

the allocation of gas to impacted shippers and therefore lead to less accurate cost allocation. We therefore consider that it would be inappropriate for the alternative PPM profile to apply for less than a full 12 month (or multiple thereof) cycle<sup>15</sup>, allowing these seasonal effects to balance out. Indeed, during workgroup discussions we sought to ensure that shippers would not be able to opt in and out of the profile for part of a year.

In our decision to accept UNC451AV, we stated our expectation that further consideration would be given to the role PPM profiles may have post-Project Nexus. We noted that both profiles and Aqs will still be needed for the initial allocation of gas, even if subsequent reconciliation mitigates the financial impact of their imprecision.

We remain of the view that there may be an enduring role for PPM profiles. In particular, gas allocation to supply points in product categories 3 and 4 will still be based upon profiles, with subsequent reconciliation of product 4 sites also being reliant upon profiles of daily consumption. So, to the extent that the elasticity of seasonal demand of PPM customers continues to differ from that of credit customers and those supply points remain in settlement product 4, the issue which UNC451AV seeks to address will exist post-Nexus.

### Retrospectivity

We consider that retrospective modifications can be detrimental to market confidence and effective competition more generally. We therefore accepted UNC451AV rather than UNC451V as there was insufficient justification<sup>16</sup> for the proposed PPM profile to be implemented with retrospective effect from 1 October 2012. However, the proposer of UNC507 considers that UNC451AV also contains a retrospective element, given the intended back dating of the adjustment to 1 February 2014. We disagree with this.

As noted by some respondents, it was known throughout the development of UNC451V and UNC451AV that the new PPM profiles and associated systems applications would not be completed until sometime after any decision to implement either proposal. However, UNC451AV was specific in that it could only take effect from a date following our decision. Therefore, although there would be a backdated adjustment once the PPM profiles are complete this will be in accordance with prevailing UNC rules and is fundamentally the same as any other aspect of reconciliation provided for in codes. We therefore do not consider that UNC451AV has retrospective application.

In contrast, UNC507 itself has a degree of retrospection as it seeks to amend contractual provisions that have now been in effect for several months. However, we do not consider the consequences of retrospection to be material in this case. In particular, there is already a degree of uncertainty on adjustments to energy invoiced because the final PPM profiles are yet to be finalized. While shippers may have made estimates based on the draft profile, pending the completion of the PPM profiles the exact scale and direction of that adjustment for any given day or month has not been known. As such, we consider the additional uncertainty caused by the degree of retrospection in UNC507 is limited. We further consider UNC507 would have little net impact upon those shippers whose portfolio reflects the typical balance between credit and PPM customers and therefore not have any material adverse effect on competition, market confidence, etc.

Therefore, whilst we disagree with some of the proposer's rationale for UNC507, we agree that a balanced application of UNC451AV between winter and summer months (i.e. a full 12-month cycle) will further facilitate relevant objective (d).

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<sup>15</sup> As noted in the UNC507 FMR, this issue led to our rejection of iGT054: ['Alternative profile for pre-payment meters'](#).

<sup>16</sup> Our published criteria for which is available on the Ofgem website, as part of the following document: ['Ofgem's Guidance on Modification Urgency Criteria'](#).

## **Relevant objective (f) Promotion of efficiency in the implementation and administration of the Code**

A common theme from respondents opposed to UNC507 was that it would be detrimental to the efficient implementation and administration of the UNC, with particular reference to the work that has gone into UNC451AV. We acknowledge that a considerable effort has gone into the development of UNC451AV (and UNC451V) and subsequently the PPM profiles. Whilst we cannot quantify this effort, we note that the estimated implementation costs of UNC451AV were £200,000 to £350,000.

As part of our decision on UNC451AV we noted that the UNC modification rules allow for matters that had been subject an urgent modification to be referred to a workgroup. This allows for a fuller consideration of issues than may have been practicable under the original urgent timetable. We noted that such a review would be appropriate for UNC451AV as it would, for instance, allow the Demand Estimation Sub-Committee (DESC) of the UNC to consider the appropriate PPM profiles to be applied for the 2014/15 Gas Year.

The UNC Panel subsequently referred the matter to DESC as suggested, and work has been ongoing since that time to develop PPM profiles for each of the LDZs and for Gas Years 2013/14 and 2014/15. The draft profiles were circulated to shippers for comment on 1 October and subsequently agreed at the DESC meeting of 15 October 2014. Separately, Xoserve has developed the associated systems changes to allow for an adjustment between the two profiles, recently confirming that it is scheduled for release on 10 January 2015<sup>17</sup>.

We also note and sympathise with the UNC Panel's concern that it would be inappropriate to set aside previous decisions on the basis of late delivery of data/systems. However, we do not consider that implementing UNC507 would set aside our decision on UNC451AV in practice or effect, nor in the absence of a firm deadline do we necessarily consider that the PPM profiles and associated systems have been delivered late. Although UNC507 provides that if the PPM profile has not been fully developed by 1 January 2015 there will be no adjustment under UNC451AV, this is a moot point with the profiles for each LDZ having now been agreed by DESC. The effect of UNC507 will therefore be limited to giving more specific parameters to the application of PPM profiles, the benefits of which are, as set out above, consistent with our rationale for accepting UNC451AV.

We also note the comments that reducing the applicable lifespan of UNC451AV may negate some of the benefits originally cited in to justify its implementation costs, and to that extent agree that UNC507 could be considered detrimental to relevant objective f). However, we must balance those concerns against the other relevant objectives and, taking UNC507 entirely on its own merits, in this case we consider that they are outweighed by the benefits to relevant objective (d), as set out above.

### **Decision notice**

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority hereby directs that modification proposal UNC507: '*Changing the effective date of 451AV (Individual Settlements for Pre-Payment & Smart Meters)*' be made.

### **Rob Church Partner, Retail Markets**

Signed on behalf of the Authority and authorised for that purpose.

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<sup>17</sup> Xoserve communication ref: 1323.3 – LH – DA, dated 19/09/14