Representation - Draft Modification Report UNC 0687V

Creation of new charge to recover Last Resort Supply Payments

Responses invited by: 5pm on 30 December 2021

To: enquiries@gasgovernance.co.uk

Please note submission of your representation confirms your consent for publication/circulation.

Representative:	George Moran
Organisation:	British Gas
Date of Representation:	30 December 2021
Support or oppose implementation?	Oppose
Relevant Charging Methodology Objective:	**a)** None **c)** Negative

The consultation is aimed at establishing if the content/effect of the variation have caused you to change a view that you previously expressed, or to take a view that you had not previously considered. Please note any representation received in respect of Modification 0687 will be carried forward should parties not wish to change their original representation.

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

1. Distributional Impacts (negative impact on Relevant Objective c)

Prior to the reprioritisation of 0687, prudent suppliers will have made pricing calculations on the basis of the current LRSP regime and indicative distribution charges. The late reprioritisation of 0687 and introduction of 0687V have led to significant uncertainty for suppliers on future costs. Implementation of this Modification will result in negative impacts for domestic suppliers through further cost increases and a windfall for non-domestic suppliers, who would have priced in the originally anticipated cost levels for their customers. Given current market conditions, this may present an additional unforeseen risk to some domestic suppliers.

Furthermore, the methodology does not serve the policy intention of allocating cost burden to the sector from which it resulted as it will lead to cross-subsidisation through the timing of allocation, the nature of the fixed charge and calculation method (see responses below to Legal Text and Q2).

2. Implementation Risk (negative impact on Relevant Objective c)

0687V has not been subject to sufficient scrutiny and analysis by stakeholders due to the desire for expedited implementation. This presents a high risk that neither the

methodology proposed nor the systems change solution will be fit for purpose, with potential negative impacts across industry, and for both domestic and non-domestic consumers.

We are concerned with the explanatory comment above that original views from 2019 will be carried forward should parties not wish to change their original representation. It is clear that these responses may no longer be relevant as the Modification has been amended and the market circumstances have changed significantly. There is a clear example in the British Gas response dated 6 September 2019, where we stated our view that the proposed change was not proportionate to the relatively small scale of SoLR claims, which were quoted as around £5.9m at the time of the original proposal. The significant increase in the quantum of claims (now estimated at around £900m) means we must re-evaluate that view: the scale of claims today is such that it absolutely requires any change to be proportionate and sufficiently robust to avoid further risk and disruption to industry and all customers. Hence we believe this proposal requires much greater scrutiny and we cannot support a workaround, temporary systems change solution for implementation.

3. Price Cap Implications (negative impact on Relevant Objective c)

The current default tariff Price Cap allows for LRSP costs, but does not allow for recovery of a fixed charge element, which this Modification aims to introduce. If an efficient supplier is unable to recover its costs, then this will adversely affect competition in supply (and could even lead to more SoLR instances). 0687V cannot be implemented without and until such a change to the Price Cap methodology is made.

Ofgem has indicated orally that it believes that implementation of 0687V is contingent on the Price Cap being amended and is consulting on amendments to Price Cap methodology to incorporate a fixed charge. However the Draft Modification Report and 0687V do not state that implementation of the Modification is contingent on changes to the Price Cap.

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

We prefer a lead time of 12 months. Lead times of 12 months or longer are customarily applied for change resulting in significant cost reallocation between sectors (e.g. CMP308) to allow industry parties to adjust their pricing and commercial practices, and provide adequate signals to customers. 12 months would also allow for the Option 1 (comprehensive solution) systems change to be developed and implemented.

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

In the prevailing baseline, this new charge is not catered for in the Price Cap and would lead to unjustified losses for domestic suppliers – potentially leading to further SoLR instances.

We have not assessed potential system costs as a solution is not clearly defined.

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

No.

At 11.1 the Legal Text provided makes reference to the conditions of 0687V applying to claims received in accordance with Standard Special Condition A48 of the Transporter Licence. This licence condition requires claims to be submitted prior to 31 October for recovery of funds by the transporter in the following regulatory year (i.e. from April 2022). In its letter of 1 December Ofgem made clear that in the current exceptional market circumstances, it would be in the consumers' interest for GDNs to process claims made after 31 October and they will not be subject to enforcement action in this case. Ofgem consented SoLR claims on 17 December 2021.

However, 0687V does not permit GDNs to recover these December 2021 processed claims via their charges until 2023/24. If the intention is for sums to be charged from April 2022, this is counter to the Transporter Licence.

At 11.2 the legal text requires the charge to be based on number of meter points at the time of appointment of the supplier of last resort ("Relevant Date"). This adds unnecessary complexity as suppliers will have been appointed at different points in time. It also means charges will systematically over-recover as the applicable charge will not take into account the natural growth in customer numbers and thus meter points since the appointment of the SoLR through to the end of the relevant charging year, although the charge will be applied to those additional customers. This systematic over-recovery predominantly affects domestic customers, but the over-recovery is to be returned through the "k factor" and so will be spread across all customers (domestic and non-domestic), resulting in a cross subsidy from domestic customers to non-domestic customers.

By way of illustration, if the SoLR charge is based on meter point (customer) numbers that are 1% too low, this would result in domestic customers overpaying by c. £9m (based on c. £900m recovered in 2022/23) and this will be returned to all customers, domestic and non-domestic, through reduced transportation capacity and commodity charges. We note in comparison to this figure the £5.9m of total SoLR claims highlighted in 0678V.

These issues are clearly material and representative of the benefit of further analysis and review of this Modification in the current exceptional situation.

We also note that the revised modification now includes an April 2022 implementation date as part of the revised legal text. Whilst we understand the proposer's desire is to have the change implemented in April 2022, it is neither necessary to include the date to deliver the stated reason for the variation, nor is it appropriate for the legal text to seek to remove the Authority's discretion on implementation timings.

Modification Panel Members have requested that the following questions are addressed:

Q1: What are the impacts for industry if the mandatory timeframes for changes to DN tariffs are not met?

Amended Price Cap methodology and tariff level must be published by Ofgem no later than the fifth working day of February for the charge restriction period commencing 1 April 2022. Therefore, we believe GDN tariffs must be published by 31 January to provide sufficient time to validate the inputs to the April 2022 Price Cap. If final GDN tariffs are not published by the end of the fourth working day of February, they will not be able to be included in the Price Cap for April 2022.

Q2: Based on the estimated SOLR levy costs published by DNs on 01 November 2021 which total approx. £900m (available in indicative charging statements, albeit with uncertainty, here: https://www.gasgovernance.co.uk/indic/2022, and an indicated split between domestic (80%) and non-domestic (20%) based on 0687, do Parties have any comments on the methodology proposed in 0687V?

It is not clear on which basis the assumption of an 80:20 domestic/non-domestic split has been made or is used in the question. 80:20 is not referred to in the DMR of 14 December 2021. It appears in the July 2019 version of the 0687 Modification as the split assumed between credit balances and residual costs, which is no longer a feature of the Modification.

The example in the DMR and 0687V document shows a split of 20m/0.5m meter points in the market (98:2 split). The failed supplier itself in the example is assumed to have a 90:10 split. The Ofgem allocation between sectors is based on 96:4 split in the same example. It is not clear from the example how Ofgem arrives at 96:4 to allocate total LRSP costs from the assumptions indicated. It is also unclear from the methodology and legal text how the split would be derived, and so it is purely at the discretion of Ofgem.

Continuing with the example, which is the only indication of the application of the revised methodology, the total LRSP cost is allocated to GDNs according to their total meter point share of the market (domestic plus non-domestic). Each GDN's pot is then allocated to sectors by the same 96:4 domestic/non-domestic split. The fixed charge per meter point is specific to each GDN's mix of connections however: the customer charge on a GDN level is calculated by dividing the pot of money per sector by the number of meter points per sector. The mix of domestic and non-domestic customers connected to a GDN will vary from the overall 96:4 split which would lead to some users – domestic and non-domestic – being over or under-allocated cost dependent on their location.

In summary, it is not clear the domestic/non-domestic split is derived in a manner which reduces confusion on how costs are allocated, nor how the method would avoid cross-subsidy. The policy intention to allocate costs to the sector which has led to those costs is not served. The allocation of a cost burden of c.£900m should be fully understood and demonstrated prior to implementation. The methodology in 0687V has not been reviewed and tested by a Workgroup and the application of the method in the example provided is inadequate and unclear. Given current market circumstances, it is crucial that further analysis such as production of revised indicative tariffs using the proposed methodology and the same c. £900m assumption used in the original indicative tariffs is undertaken to indicate to parties the impact of the change.

Q3: What is the impact on markets and industry of the inclusion of wholesale costs in the varied Modification 0687V?

In the 0687V solution outlined, the inclusion of wholesale costs in the LRSP pot for recovery from both domestic and non-domestic meter points does not meet Ofgem's policy intention to allocate the costs for recovery from the sector which gave rise to them.

Q4. Do parties have any comments regarding the technical delivery of the Code solution proposed by the CDSP and under discussion at DSC Change Management Committee as detailed here: https://www.xoserve.com/change/change-proposals/xrn-4992-modification-0687-creation-of-new-charge-to-recover-last-resort-supply-payments/

(Note this has been progressing under the standard process through the DSC Change Management Committee since 2019, so more up to date information is available - Option 4 – interim for 01 April 2022 implementation and Option 1 enduring for future implementation).

There is inherent risk in the Xoserve system change option proposed. Firstly, it is a workaround rather than a complete solution. Secondly, it was not part of the Final Modification Report for 0687 nor the Draft Modification Report for 0687V and has not been given adequate assessment. Thirdly, Xoserve itself has flagged in recent days that: "*there is a significant amount of change planned between January and April 2022. This brings inherent risk into our delivery and support of critical production services and processes*".

We understand that Xoserve has commenced detailed design work on the change, working "at risk". This represents potentially inefficient use of time and funding. It also makes it impossible for industry to assess the solution fully.

A short-term workaround solution is not suitable for recovery of such a large sum. Procedurally, implementation should be delayed until a robust enduring solution can be delivered for the systems change, properly assessed by industry, and introduced at a point in time when it can be managed adequately by the provider. A comprehensive solution was proposed as Option 1 in 2019 with an estimated 12 month development and implementation timeline. The use of this comprehensive solution, with an adequate development, testing and implementation timeline to ensure robustness would mitigate much of the risk raised above in response to this Q4. The knowledge that a better solution concept exists, ready to be worked up, makes deployment of a temporary workaround because of a desire to expedite proceedings due to process failings appear yet more problematic.

Q5: What is the impact on industry of the timeline of this Modification?

Consultation close out 5pm	*30/12/21*
FMR to Panel for reading	*05/1/22*
Panel consideration	*12/1/22*
FMR to Ofgem	*12/1/22*
Ofgem decision expected	*20/1/22*
Deadline for publication of DN charges	*31/1/22*

The overall timeline and process for this Modification has been very poor. The original Workgroup development work is now outdated by the change in market circumstances since 2019, the number and scale of SoLR events in 2021, and the variation to the Modification proposal itself. The lack of any further review, analysis or development due to the timeline for this Modification presents a major risk that both the solution and the systems implementation are inadequate. With the scale of disruption and increased costs faced by all energy users, this risk should be taken very seriously.

Contingent change to the price cap methodology is running in parallel to the Modification timeline, placing additional pressure on parties who are affected by both, and further increases risk of sub-optimal outcomes.

The condensed timeline for this Modification and Ofgem decision mean that there is uncertainty for both domestic and non-domestic customers costs. Indicative charges have already been published by GDNs on the basis of the current regime and Ofgem's letter of 1 December 2021 on SoLR levy claims. This information will have been used in pricing calculations prior to the reprioritisation of 0687. The uncertainty presented by 0687V means that a prudent supplier must now price in the higher cost outcome for both sectors (i.e. overall customers entering into contracts will be over paying until the final decision, regardless of what that final decision is).

Extreme and unnecessary pressure is being placed on industry to deliver to Ofgem's desired timeline for this change. Implementation timing should not be prioritised over delivering a solution that is fit for purpose, and here this necessitates a better understanding of the impacts on domestic and non-domestic customers.

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

As this variation has been rushed through, there are multiple errors and omissions resulting from the DMR 14 Dec 2021 draft consisting largely of the version completed in 2019. We are understanding of the administrative challenges for Joint Office under the unnecessary time pressures that have been placed on them, however in our view errors and omissions in the FMR mean that it is misleading and not fit for purpose. We highlight three clear examples:

At p. 11 the DMR states that "*The Workgroup has considered the Legal Text and is satisfied that it meets the intent of the Solution*". Modification 0687V states that Legal Text is to be provided. In fact, the Legal Text has been issued, but has not been reviewed by a Workgroup. Therefore the DMR misleads in its statement that Workgroup is satisfied with the Legal Text.

The content and examples referencing 2018 SoLR events do not take into account the scale of LRSP claims in 2021. The materiality of the claims must be made clear in order for the solution to be assessed. This could easily have been done by the proposer in the variation request, as calculations were updated with the change to the calculation formula, but it was not. Supplemental information to the context could also have been added. As the DMR and 0687V Modification stand, they mislead on the quantum of LRSP and potential impacts to domestic and non-domestic customers, and industry.

The implementation of the modification by Xoserve is proposed to be based on an option that is not included in the DMR. As highlighted in the questions proposed by Panel for inclusion in this consultation, the systems change is being progressed under a separate DSC process. However, system change implementation is a key element to inform industry response to the standard consultation questions on impact and implementation lead times. The DMR/0687V omit essential information.

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

No further information provided.