

**Centrica response to the CMA's Formal
Consultation on the Energy Market Investigation
(Gas Settlement) Order 2016**

18 November 2016

Introduction

This response provides Centrica's comments on the CMA's drafts of:

- The Energy Market Investigation (Gas Settlement) Order 2016 including:
 - Amendment to SLC 21B of the Gas Supply Licence (Schedule 1 to the Order)
 - Amendment to SC 11 of the Gas Shipper Licence (Schedule 2 to the Order); and
 - Amendments to the Gas Transporter Licence (Schedule 3 to the Order).
- The Draft Explanatory Note for the Order.

Our comments on drafting of the order and the proposed licence amendments have been included as an Appendix.

Summary

A number of issues were raised in response to the CMA's first consultation paper on the draft 'Gas Settlements Order', which have not been recognised in the Formal Consultation paper; as such Centrica's position remains unchanged.

Centrica remain committed to improving outcomes for its customers and would expect industry change to support this, however the proposed remedies will not do so. Ultimately, increasing the meter read frequency will improve the speed of reconciliation but will not reduce the volume of unidentified gas and will therefore not address the issue identified in the CMA report associated with the *'inefficiencies in the allocation of the cost of unidentified gas'*.

Our response focuses on the following points:

1. The Order involves a material change to Project Nexus and industry-wide settlement arrangements
2. The proposals require significant additional cost to undertake fundamental changes to core IT systems
3. Consumers will not see any non-Project Nexus related benefits unless the inefficiencies in the allocation of the cost of unidentified gas are addressed;
4. Xoserve processing capability is not sufficiently understood

The remedies package published in the CMA Final Report¹, to address the Gas Settlement AEC stated: *'With respect to all non-daily metered supply points with a smart or advanced meter, an order on gas suppliers (and amendments to the suppliers' standard licence conditions) to submit valid meter readings (as defined in the Uniform Network Code) to*

¹ CMA Final Report 20.27 (c)

Xoserve at least once per month (unless for reasons of malfunction or related issues it was not possible to take such a meter reading)'.

The remedy does not make any reference to the provision of a daily read and the inclusion of this requirement in the Order represents a material change to the CMA's position since the publication of the report in June.

The CMA's final proposals and requirements of Nexus resulted in suppliers having a legitimate expectation of the change necessary to comply with this remedy. If our understanding of the CMA's intent is correct – namely that daily reads are required for settlement – this represents a retrospective change to specified and understood arrangements.

In such circumstances, we believe the CMA is legally obliged to undertake and consult upon a full impact assessment that quantifies the costs and benefits of daily meter read submission against the previously stated monthly read requirement. Without it the CMA cannot be confident that its proposed intervention would benefit consumers or be compatible with statutory duties and obligations.

As the CMA will be aware from its enquiry, Project Nexus has been the subject of extensive industry discussion and collaboration. Supplier planning and investment decisions have been made on the basis of delivery against the Nexus specification. At no point during this extensive process have suppliers contemplated a move to mandated daily read provision for all supply points as now proposed by the CMA.

If implemented, the CMA's proposal involves material challenges in terms of change, additional cost and operational complexity. Initial assessment of the changes required suggests that the cost will be significant and could rise following more detailed analysis. These are costs that will ultimately be borne by consumers.

Equally significantly, there are material concerns about Xoserve's capacity to manage the proposed increase in read volume. Consequently, any IA also needs to consider the additional changes to be implemented by Xoserve and the associated costs (which would be incurred by Xoserve and ultimately suppliers and consumers). The IA would also need to factor in the potential for delay to Project Nexus and the benefits from the scheduled Nexus implementation that are foregone if the CMA's remedy were to be implemented.

The implementation of Project Nexus has already been subject to considerable delay and its delivery remains complex, challenging and not without significant risk. Introducing unnecessary, additional risk at the point of implementation, or shortly thereafter, does not appear to be sensible given the implementation complexity.

The case for an IA is made even more compelling by the fact that our analysis reveals that the proposal is highly unlikely to address the competition concern identified in the CMA's market investigation. Accordingly, we do not believe that, in pursuing it in its current form, the CMA is meeting its duty (under s138(2) of the Enterprise Act) to remedy, mitigate or prevent the AEC. However, even if the CMA might be able to demonstrate convincingly that

the remedy would address an AEC, the level of risk and disbenefits inherent in the proposal would mean that the remedy would be disproportionate and unjustifiable.

We request an urgent meeting with the CMA and Ofgem to discuss our concerns and articulate further the implementation challenges and complexities that the proposals introduce so that the CMA is adequately equipped with the necessary inputs before adopting any decision.

1. The Order involves a material change to Project Nexus and industry-wide settlement arrangements

Daily Read Provision

A move to daily meter read provision in the gas market is the equivalent of introducing half-hourly settlement in electricity; therefore we would expect such a fundamental decision to be subject to the same good regulatory process i.e. the completion of an Impact Assessment, especially as such frequency of read provision was not apparently considered during the Energy Market Investigation (EMI).

Transition to daily meter read settlement arrangements will require Suppliers to make significant amendments to their processes and systems, over and above the extensive changes currently being made to deliver Project Nexus.

The Project Nexus arrangements have been designed to enable Supplier discretion on the use of Product Classes (PC) 2-4. Therefore not all Suppliers will have built and/or tested functionality to operate within all PC's in readiness for the Project Nexus Implementation Date (PNID) and may not have built the capability to submit 365 meter readings for each supply point per annum.

Any requirement to introduce mandated daily read provision will require a significant programme of work for Suppliers to design, test and implement a solution.

Monthly Read Provision

We remain concerned about the proposal to implement the provision of monthly reads into settlement from PNID. As a supplier, we face significant changes to our Nexus design at a late stage in the process to enable the provision of monthly meter readings for all of our smart meter population at PNID. This is in addition to our reservations relating to the introduction of unnecessary, additional risk to PNID which are expressed later in this response.

Whilst the CMA Final Report² referred to the provision of a read at least once per month for smart and AMR meters, the report did not say when this would be implemented and given the wider industry challenges associated with the critical, successful delivery of Project

² CMA Final Report 20.27 Remedies concerning the Gas Settlement AEC

Nexus, we did not expect that any new obligation regarding the provision of monthly meter reads would be aligned with PNID.

Consequently, considerable changes are required to systems and processes to be able to provide mandated monthly reads for all of smart meters from PNID.

These changes are both complex and costly in themselves, but complicated further by the need to establish a stable code base as we enter the latter stages of Nexus delivery. The requirement to introduce such fundamental change to our base-lined Nexus design at this stage of the project (and after the completion of industry market trials) is extremely difficult and adds unnecessary risk and cost. It also as explained above, does not, in our view, remedy the AEC in any event.

We recommend that the implementation of monthly read provision should not be introduced at PNID. Instead, it would be prudent to implement this once the new SAP system has been successfully implemented, proven to be stable and any major defects addressed.

Once PNID occurs Xoserve will be working on a fix forward basis to address any issues or defects that may need to be resolved. The programme's post implementation hypercare arrangements anticipate that a series of changes will need to be progressed, delivery of which will need to be prioritised by both Xoserve and market participants.

2. The proposals require significant additional cost to undertake fundamental changes to core IT systems

The costs associated with delivering monthly read capability from PNID and daily read capability from PNID+6 months will be substantial. Further, there will be additional operational and resource costs associated with the introduction of new or amended processes e.g. exception handling capability.

We would welcome the opportunity to discuss our issues and concerns with the CMA and Ofgem in more detail to fully explain the level of cost and complexity of the changes required and the time we estimate they would take to deliver.

We are concerned that the CMA and Ofgem hold an inaccurate view that the cost challenges faced by suppliers, associated with the implementation of this Order, solely apply to remote read procurement and storage costs, that the costs/changes are assumed to be negligible and therefore that no detailed cost/benefit impact assessment beyond the Energy EMI is required. In our view the costs associated with the delivery of these changes will significantly outweigh any benefits to consumers resulting from daily read rather than monthly read reconciliation and such meter read frequency was not considered during the Energy EMI.

The CMA Final Report stated that for smart and AMR meters, valid meter readings would need to be submitted at least once per month. The remedy did not make any specific reference to suppliers being required to submit daily meter readings into settlement. The

proposed changes and supplementary amendments to the Uniform Network Code (UNC) will introduce mandatory use of PC3 for all smart and AMR meters.

The new obligations in the Order fail to deliver the benefits that the CMA and Ofgem have identified and, in fact, fail to remedy the AEC whilst imposing unnecessary and unreasonable costs and complexity on the industry. It would be a perverse outcome if a move to daily meter read provision for settlement actually increased costs to consumers, rather than addressing inefficiencies in cost allocation.

It is therefore essential that an Impact Assessment occurs and considers the whole range of system, process and contractual changes that will be required to be made by suppliers and other industry participants, and the costs associated with these. It would be irresponsible for these changes and costs to simply be assumed as being inconsequential. At the very least, we expect the CMA to be able to demonstrate how its proposals meet its obligations under the Enterprise Act.

3. Consumers will not see any non-Project Nexus related benefits unless the inefficiencies in the allocation of the cost of unidentified gas are addressed

We agree with the CMA Final Report view *'that the main inefficiencies that will subsist after implementation of Project Nexus relate to the presence of a (residual) amount of unidentified gas'*. We also agree with the CMA when they note that there are *'inefficiencies in the allocation of the cost of this residual unidentified gas'*.

Paragraph 12.153 of the CMA Final Report states that the obligation to introduce the provision of a meter reading at least once per month for smart and AMR meters *'...should lead to a more efficient allocation of costs between shippers and suppliers (due to the use of actual consumption data) and a reduction in unidentified gas (which would also contribute to a more efficient allocation of its costs between shippers and suppliers).'*

The volume of actual unidentified gas (energy) will not be altered by a change to speed of individual supply point reconciliation. Increased read provision may change the timing of gas reconciliation, but will not address the volume reconciled, the causes of unidentified gas or the efficient allocation of its cost to suppliers or consumers.

Further, the proposals will not result in a reduction in unidentified gas. As we have previously stated to both Ofgem and the CMA, we are of the view that once meter point reconciliation occurs for all supply points and, as a result, the industry has a true understanding of the actual volume of unidentified gas, the overall volume may increase rather than reduce. Full reconciliation of supply point consumption will remove any anomalies introduced by existing AQ values/process and will result in a more accurate view of the total volume of unidentified gas which is attributed to issues such as theft, measurement error and shrinkage inaccuracy.

As unidentified gas costs are subsequently passed on to shippers and ultimately consumers. The net result of any increase in unidentified gas volume, regardless of whether we use daily

or monthly readings for reconciliation, will be an increase of costs to shippers and consumers which we believe will not deliver the stated '*more efficient allocation of its costs between shippers and suppliers*'.

We understand that this remedy aims to address the issues stated above. Unfortunately, it is not evident to us how the proposed Order, as drafted, will address these aims or deal with the inefficiencies identified. As such, this does not appear to meet the obligation imposed on the CMA to remedy the AEC.

The implementation of Project Nexus will deliver individual meter point reconciliation and a rolling Annual Quantity (AQ) value. AQ's will only be able to be amended once per month; therefore the provision of a monthly read will suffice to achieve the most possible frequency of AQ update and the provision of daily reads will not impact the monthly AQ calculation.

We held a discussion with the CMA and Ofgem on 1 November to discuss the drafting of this Order and some of the concerns we have. During the conversation, all parties agreed that the total volume of energy reconciled for a supply point over a set period of time will not differ, regardless of the read/reconciliation frequency i.e. whether a meter is read daily, monthly or annually. Only the speed of reconciliation will differ and, although there would be increased granularity of known energy usage across the period, this has no impact on the allocation of unidentified gas.

We further discussed the CMA/Ofgem view that daily reconciliation will address any peaks or troughs in the daily System Average Price (SAVP), enabling all meter point consumption to be reconciled at the daily SAVP via the use of daily reads, rather than being averaged over a longer period of time (which, we note, would be at most one month should monthly read provision be mandated rather than daily). We note that no examples have been provided to demonstrate the materiality of benefits to consumers of daily reconciliation versus monthly reconciliation. Further, we do not support the Ofgem view that if the information is available it should be used. A case needs to be made with a supporting cost/benefit Impact Assessment, given the significant amount of change that will be required to introduce daily read provision.

Indeed, given the way that individual supply point reconciliation will operate under Project Nexus, the actual energy bill that consumers will continue to receive will not be impacted by daily read reconciliation to a daily SAVP.

We remain of the view that daily reconciliation will not directly benefit consumers and that the proposals contained within the Order will not address '*inefficiencies in the allocation of the cost of this residual unidentified gas*'. As such, this proposed remedy will not remedy the AEC.

Implementation timing and risk posed to Project Nexus

We are concerned that the implementation approach detailed within Paragraph 20b of the Draft Explanatory Note, will introduce unnecessary, additional risk to Project Nexus implementation. The provision of additional meter reading volumes at this time will not deliver benefits to consumers that will outweigh the significant, additional risks being

introduced. We therefore recommend that the introduction of an obligation to provide monthly meter readings does not take place until such time that the new SAP system has achieved stable live operation, which can be determined by the Project Nexus governance arrangements led by Ofgem.

Further to our recent conversation with the CMA and Ofgem and in light of the drafting of Part 2 20c, whilst we do not support the introduction of mandatory daily read provision, we welcome the pragmatic approach that is being proposed by the CMA in respect of the timing of introducing daily read requirements.

Project Nexus will enter into a critical period of hypercare post implementation, and Xoserve's focus will need to be on fixing any issues and defects and establishing a stable environment. At this time, nobody is able to gauge, with any certainty, the duration of the hypercare period. Therefore, we agree that a consultative approach will be required and agree with the CMA view that it will be important to *'seek and have regard to representations from gas suppliers and other relevant stakeholders'* before any further implementation date is directed.

4. Xoserve processing capability is not sufficiently understood

We remain extremely concerned about the volume of meter readings that the Order, as currently drafted, will require suppliers and Xoserve to obtain, store, validate and process. In our response to the Draft Order consultation, we highlighted that a move to default PC3 for all supply points would equate to ~8.7 billion reads per annum once all meters have the ability to be remotely read.

During the scoping of the business requirements for Project Nexus, an assumption was made that all four settlement PC's would be utilised by suppliers for meter read provision and settlement purposes. We know from discussions with Xoserve that the new system has not been designed on the premise that all 24 million supply points would be providing a daily meter reading into settlement.

The modification proposal that introduces the Project Nexus arrangements into the UNC, enables a supplier to choose which PC to use for each supply point (with the exception of those that fall within mandatory PC1). Supplier design, build, testing and implementation approaches will have subsequently been designed and executed accordingly.

We are concerned as to whether Xoserve/the new system will be able to deal with the large read volumes associated with what will ultimately be a mandatory use of PC3 for all meters that are able to be read remotely, which in time will be all 24m meters (~720 million reads per month, being provided and processed within a limited timeframe window, in accordance with UNC rules). During Nexus development and testing numerous issues with file sizes and volumes have been encountered by Xoserve, so any further volumetric increases need to be fully impact assessed and tested.

In addition to the volumetric and processing pressures that ~720 million reads per month will introduce, there will clearly be hardware implications for Xoserve and consequential

operational and system implications to both Xoserve and Shippers associated with such issues as the processing of large exception volumes, large increases in monthly invoicing data and the increased monthly AQ file sizes. All of these issues, plus others, will require serious consideration. We are also mindful that the non-functional requirements work undertaken by Xoserve during Project Nexus will also need to be reviewed.

As part of this consultation process, we expect Xoserve to undertake a full assessment of the system and process implications that both monthly and daily read provision will introduce. Xoserve will need to prove that they are capable of processing these larger volumes and confirm what the associated costs are with regards to elements such as additional processing, storage, archiving and exception handling. Any assessment should also provide information as to any consequential impacts to shippers and confirmation as to whether they will need to upgrade their file transmission mechanism and the industry network arrangements. It is vital that this information is shared with all market participants as soon as possible.

Ongoing delays to implementation have severely impacted suppliers' confidence in Xoserve's ability to deliver Project Nexus to stated timescales as many project milestones and implementation dates have been missed over the past two years. We recommend that any assurances provided by Xoserve with regards to their ability to deal with increased meter read volumes in the short, medium and long term are independently verified by an entity that has experience in SAP implementations of this size and complexity.

It is essential that all market participants have absolute confidence that Xoserve's processes and systems will be able to consistently process the increased volumes of meter reads, without impacting other elements of its processing capability. Given the amount of additional change and costs that suppliers will be required to undertake to deliver daily read provision, we believe it is not unreasonable to request solid assurances that Xoserve will indeed be able to manage.

Appendix

Comments on drafting of the Order and the proposed Licence amendments

The comments below are made in the context of, and are subject to, our substantive response, in particular in respect of the requirement for daily meter readings to be taken and the consideration of the impact and timing of wider industry changes.

Comments on the main body of the Order

- **Timing:** In respect of the precise timing of implementation, please see the main body of our response. In respect of the drafting, the whole order could be in force but certain obligations could be expressed to take effect at a later date as otherwise, if the effectiveness of the Order is staggered, some provisions of the Order refer to other provisions which are not yet technically in existence. For instance, Article 1.2 says that all provisions come into force in December 2016 except Article 3. Article 4 refers to Article 3.1 which doesn't make sense if, as provided for Article 1.2, Article 3 isn't in force until the Project Nexus Implementation Date.
- **Article 1.4** should be subject to the termination provision in Article 8.1.
- **Articles 3.3 and 3.4** – Article 3.3(a) should be “subject to” Article 3.4. Article 3.4 provides, in line 4, that suppliers need to take all reasonable steps “to obtain” Valid Meter Readings “for every day” but then the penultimate line of Article 3.4 says that Valid Meter Readings “are to be obtained once a month”. Should the penultimate line read that Valid Meter Readings are to be submitted monthly in accordance with Article 3.3 rather than obtained monthly or is it the case that the Valid Meter Readings need to be obtained “in any event” monthly?
- **Relevant Gas Transporter or CDSP:** Given the progress of the FGO programme³ and the timing of the Order coming into effect, consider whether some of the references to the Relevant Gas Transporter in licence and Order should be to the CDSP.

Comments on the amendments to the licence conditions

- **21B.4A** – As above in respect of our comments on Article 3.4, the drafting needs to clarify the link between “obtaining daily readings” in line 3 of 21B.4A and collecting them “at least once per month from each Customer” at the end of 21B.4A.

21B.4B – The drafting provides that “the licensee must provide daily or with such frequency as provided for under the UNC” all meter readings obtained under 21B.4.A (daily reads) and 21B.4(b). However, 21B.4(b) provides for reads at least once a month i.e. not daily, so is the reference to 21B.4(b) correct?

³ Due to be implemented on 1 April 2017