

npower
Gas Settlement Order – Consultation
Response dated 17 November 2016 Non Confidential

Part 1: Summary

1. The CMA's original remedy as published in the CMA Final Report in June 2016 effectively moved all Smart and Advanced meters into the new Nexus read category of Product Class 4 monthly submission. npower agrees with the original CMA remedy requiring gas suppliers to submit at least one read a year for traditional non-daily read meters; and at least once a month for Smart and Advanced meters. Monthly settlement of non-daily metered customers with the appropriately capable metering would be a significant improvement on the current arrangements in which shippers generally opt either for 6-monthly or annual read frequency cycles. However npower does not agree that monthly submission of daily granularity provides sufficient benefits for consumers relative to a single monthly read to warrant changing the remedy.
2. npower is disappointed that the CMA continues to propose that suppliers must take daily reads from Smart and Advanced meters and submit them to Xoserve on a monthly basis, effectively moving all Smart and Advanced meters into the new Nexus read category of Product Class 3 by December 2017 (or six months after Nexus Go Live). This changes the remedy from that set out in the CMA Final Report. We believe that such change contravenes the requirements of the Enterprise Act 2002 ("EA02") and provide more detail on our concerns in Part 2 of our response.
3. We believe there is no evidence to support that there are benefits of monthly submission of daily reads relative to a single monthly read. We remain of the view that a cost benefit analysis should be undertaken to assess the true benefit of such a change relative to the actual cost and that this should be undertaken under Uniform Network Code Modification 594R (UNC Mod 594R). We reiterate our point from our previous response to the initial consultation that the CMA has proposed a cost benefit analysis is undertaken by Ofgem for electricity Half-Hourly settlements proposes and we see no reason why the same is not required for a gas settlements change of this nature
4. We are concerned that the CMA is seeking to change the remedy in the Final Report without due consideration for the need to evidence expected benefits and without assessing the costs to suppliers of complying. The CMA has assumed, but has not sought to confirm, suppliers' delivery of the *non-mandatory* elements of Project Nexus. Given that collection of daily reads (either on a daily or monthly basis) was not a mandatory requirement of Project Nexus, many suppliers have chosen not to develop this functionality within their own Nexus

programmes. Development of such a change after Nexus go live is significant and costly. We provide more detail on this in Part 3 of our response.

5. Without prejudice to our concerns about the lawfulness of the modified remedy, npower notes that the CMA now proposes that suppliers begin to send batched daily reads for Smart and Advanced meters “six months after the Project Nexus Implementation Date, or any later date directed by the CMA.” Should the CMA proceed with the modified remedy, it is our opinion that six months is too close to Nexus Go Live. Project Nexus is a major industry change involving implementation of a central SAP system. Experience of the industry to date is that large scale implementations of this kind invariably result in a number of defects and issues that take some time to resolve. We also observe that there is, as yet, no clear date for Xoserve’s delivery of the Retrospective Amendments (RAASP) functionality. Should this remedy go ahead, we would advocate a minimum go live of twelve months from the delivery of RAASP.
6. Better still would be an implementation that takes into account the wider industry change landscape along with the impacts on the industry Smart Metering Implementation Plan, the latter of which must take priority.

Part 2: The CMA Process

7. In its consultation issued on 18 October 2016, the CMA has noted that it cannot modify the remedy save as provided under section 138(3) EA02 but has not sought to explain the “material change of circumstances” and/or “special reason” that the CMA considers meets the requirements of section 138(3). Based on a call between npower and the CMA on 14 November, npower understands that the CMA wishes to modify the remedy because it had not considered the specific details of the remedy prior to the Final Report and considers that the modification might better address the AEC, and because the CMA assumes that the additional costs for suppliers (and/or related parties) of complying with the modified remedy will be negligible. The CMA also appears to be relying on the fact that modification proposal 594R has been raised under the Uniform Network Code, which – if adopted following the proper code modification process – may achieve an obligation on suppliers similar to that under the CMA’s modified remedy.
8. npower has real concerns about the CMA’s approach:
 - 8.1 First, prior to publication of the Final Report the CMA appears not to have given due consideration to what is the appropriate remedy to address the AEC, as required under section 134(4)(c);
 - 8.2 Second, the CMA appears not to have considered properly whether the requirements of section 138(3) are met, or in any case has failed to explain how

they are met, making it impossible for interested parties to understand the CMA's decision making;

- 8.3 Third, the CMA has not carried out the requisite assessment of whether the modified remedy is an effective and proportionate remedy to address the AEC. In particular, the CMA has not specifically considered whether the modified remedy is more onerous than needed to address the AEC, or whether the remedy as set out in the Final Report would be a less onerous effective means of addressing the AEC.
9. npower does not consider that the requirements of section 138(3) are met. npower considers that the fact that UNC modification proposal 594R has been raised (but not yet finalised and approved) does not amount to "material change of circumstances" or other "special reason". Similarly, if the CMA had not properly considered the detail of the remedy prior to issuing its Final Report, this does not meet the test for modifying the remedy under section 138(3).
10. Furthermore, npower considers that the modified remedy would not be an effective and proportionate remedy to address the AEC. In short, the modified remedy results in substantial additional costs for suppliers, making it unduly onerous; additionally, it is more onerous than the remedy set out in the Final Report which is an effective means of addressing the AEC. We explain this further in the following sections.

Part 3: The Need for a Cost Benefit Analysis

11. It is important to note that Product Class 3 is not a mandatory requirement of Project Nexus. As such suppliers will have taken a commercial decision based on their assessment of the benefit to their customers of employing this product versus the cost of building it. Whilst some suppliers may have decided that monthly reads at daily granularity provide sufficient benefits for them and their customers to justify building the functionality, others will have decided that daily granularity does not deliver sufficient benefits. This is a legitimate business decision on their part and is entirely in keeping with the greater flexibility and ability to differentiate that Project Nexus enables. Suppliers have invested significantly in delivery of Nexus and it is disappointing that, having not addressed this prior to the Final Report, the CMA is now implying that this is not sufficient to deliver a framework that supports the future Smart world and meets the needs of consumers.
- 11.1 npower notes that had this requirement been mandated at the same time as Project Nexus it would have saved a considerable amount of the additional cost and work. Once again we see an example of how ill thought out policy changes are causing major disruption and cost to suppliers and their customers.

12. If suppliers are not already "Class 3 ready" there are a number of changes that need to take place to enable their readiness, all of which require considerable cost and time to implement. In our initial response on the draft order we provided a general view on the likely changes required.
13. In our response to the initial consultation we flagged the parallels with electricity settlement reform in respect of the CMA requirement for Ofgem to undertake a cost benefit analysis before mandating mass Half-Hourly settlements. We reiterate the need for a robust business case to justify a move to monthly submission of daily granularity for gas settlement.
 - 13.1 The cost of such changes will inevitably be borne by consumers and yet, as mentioned in our previous response, it is difficult to perceive any benefits to them as a result of moving to monthly batched reads relative to a single monthly read. The likely benefits to them as a result of moving to electricity Half-Hourly settlements, such as enabling Time of Use tariffs and consumer demand management, do not read across to gas settlement through daily reads. Consumers use gas for either heating or cooking and, in the main, it is not possible to shift such usage. Given the lack of comparability with electricity and the lack of any obvious benefits of monthly submission of daily granularity, over and above the original remedy, it is essential that the CMA provides a robust and transparent business case before moving this forward.
14. Mandated collection of daily reads will increase demand on the DCC network, which could impact their overall network costs and lead to cost increases. Suppliers are not required to pay transactional service request costs to the DCC but those costs are socialised across users based on market share who must then pass them on to their customers. These cost impacts, even though indirect, should also be included in the cost benefit analysis.

Part 4: Examination of the Perceived Superior Benefits of Product Class 3 Over Product Class 4 (monthly)

15. The implementation of Rolling AQ through Project Nexus will enable a fundamental and much welcome change in the accuracy of gas settlements. This along with the CMA's original remedy to submit a monthly read for Smart and Advanced meters will enable the reduction of the volume delta between allocation and reconciliation and at the same time reduce the ability of parties to "game." However, under the Nexus processes, reconciliation and Rolling AQ calculations for Product Classes 3 and 4 are calculated monthly therefore a single monthly read is sufficient to deliver these benefits. On this basis, npower has seen no evidence that provision of daily reads for this purpose provides any greater benefit than a single monthly read.

- 15.1 In fact, the table in Appendix 1, taken from the Project Nexus Business Requirements Definition Document (BRD)¹ shows that the new UK Link system treats all Product Classes in the same way in respect of both the timing of AQ calculations (monthly) and the number of reads used in that calculation (two). Indeed the very point of Rolling AQ is that its allocation is performed with more up to date reads, so it is a much more accurate forecast than exists today. This is especially true as we move towards monthly reads for Smart and Advanced Meters. Additionally, the table demonstrates that allocation profiles are the same for both Product Class 3 and Product Class 4 – again challenging the perception that Product Class 3 provides superior benefits over Product Class 4 (monthly).
- 15.2 In our call of 14 November, Ofgem suggested that it takes nine months for a consumer’s consumption change to be realised through Rolling AQ. It is true that from the point of meter point creation, for example for a newly connected site, at least nine months of read history is required for an AQ to roll. However, once this builds up in UK Link an AQ can roll every month if reads are submitted every month. In fact, an AQ will roll no more than 12 times a year regardless of whether reads are submitted once a month or monthly at daily granularity.
16. At present there is insufficient market-level evidence that settling domestic and microbusiness customers using read data at a daily granularity will lead to a significantly greater reduction in Unidentified Gas or inaccurate settlement of energy than could be achieved via monthly read submission for Smart and Advanced meters. If the CMA has such evidence, npower would welcome visibility of it. Mandated submission of a monthly read will make Rolling AQ more fluid, leading to more accurate allocation and also reduce the time periods between the reconciliation of this allocated energy. This in turn would lead to a reduction in Unidentified Gas. However, as Rolling AQ and meter point reconciliation will only occur once a month, regardless of whether the site is in Product Class 3 or 4, there are no obvious benefits for a mandated Class 3 (over Class 4 monthly) in terms of Unidentified Gas.
- 16.1 Ofgem has expressed the view that one particular benefit of placing large numbers of meter points into Product Class 3 would be that the Allocation of Unidentified Gas Expert (AUGE) might deem that a greater share of Unidentified Gas could be allocated to Product Class 4 over Product Class 3 and that this alone may outweigh the costs of delivering Product Class 3. Since Nexus has not yet gone live, this is as yet unknown. It is our understanding that the AUGE will deliver a new table which will apply from October 1st 2017, a draft of which will be consulted on in February 2017. In the meantime the interim table shown in Appendix 2 and referenced in the Framework for the Appointment of an

¹ Project Nexus Business Requirements Definitions Document
<http://www.gasgovernance.co.uk/sites/default/files/Annual%20Quantity%20BRD%20v5.6%20Clean.pdf>

Allocation of Unidentified Gas Expert document² confirms that from Project Nexus go live through to the start of the new gas year which begins on 1 October 2018 the weighting factors are identical between Class 3 and Class 4. It would seem then that there is little evidence at this stage to substantiate Ofgem's view.

16.2 npower notes that in its decision document for UNC Mods 473 and 473A (Project Nexus – Allocation of Unidentified Gas), Ofgem states *"We note concerns that this weighting of UG allocation may incentivise shippers to nominate a greater, and potentially inefficient, number of supply points into settlement Class 2 in order to avoid UG costs. However, while the costs of UG are significant, they make up a relatively small proportion of overall energy costs. Set against this, the Class 2 product has a number of additional requirements above those of Class 3, not least the exposure to ratchet charges. It would ultimately be for each shipper to decide whether such investment is efficient for the interim period to which these proposals apply. Market pressures should provide appropriate incentives for shippers in making these decisions."* This would seem at odds with the recent views expressed by Ofgem.³

16.3 npower further notes that in that same decision document Ofgem stated *"We consider it possible that the AUGE would, in due course, recommend a greater differentiation between Class 3 and Class 4 supply points than currently proposed. We would expect this decision to be based on evidence, reflecting the contribution that supply points make to UG under each settlement class. This may form part of shippers' consideration of which settlement class they nominate their supply points to. We recognise that such choice may not be available for supply points which do not yet have a smart meter installed and cannot provide daily readings. However, we consider that this choice provides an incentive to take on smart meters, rewarding those who have moved early to make the necessary investment."* Again this appears at odds with recent views expressed by Ofgem which seems to be moving away from commercial decisions taken by suppliers based on firm evidence.⁴

17. It has been suggested that the move to mandatory Product Class 3 will in some way reduce the risk to consumers of the effects of gas market price volatility. npower does not agree that daily market price volatility presents a significant

² Framework for the Appointment of Allocation of Unidentified Gas Expert Document 2 October 2014. <http://www.gasgovernance.co.uk/sites/default/files/Framework%20for%20the%20Appointment%20of%20an%20Allocation%20of%20Unidentified%20Gas%20Expert%20v6%204%20Proposed%20Revisions.pdf>

³ Ofgem decision document UNC Mods 473 and 473A: Project Nexus – Allocation of Unidentified Gas, Paragraph 43. 9 April 2105. <http://www.gasgovernance.co.uk/sites/default/files/UNC473D.pdf>

⁴ Ofgem decision document UNC Mods 473 and 473A: Project Nexus – Allocation of Unidentified Gas, Paragraph 44. 9 April 2105. <http://www.gasgovernance.co.uk/sites/default/files/UNC473D.pdf>

enough risk to warrant such a large scale change, either now or in the future. The correlation between the day ahead and month ahead gas forward prices is extremely high because of the nature of gas flow (flexibility on import flow, large scale storage and linepack in the pipes). The situation is completely different for electricity.

- 17.1 Whilst the submission of reads on a daily basis may provide marginally greater accuracy on cost allocation because they enable the application of a System Average Price (SAP) and Calorific Value that can be applied on a daily basis, the benefits of daily reads over a single monthly read are still unclear. To explain further, the SAP Pence Per Unit (PPU) is derived from the networks daily balancing activity and is based on all trades on any given gas day that occur in order to balance energy shortages or surpluses in the system. The SAP is an average between those daily trades, and so SAP will change, albeit not significantly, each day. The submission of a single monthly read necessitates use of a Weighted SAP which is effectively an average of all the SAP prices within a reconciliation period, typically between two meter reads across a period of time, for example, a month. The volume that is reconciled in both Class 3 and Class 4 is the same (regardless of whether there are thirty reads in that period or two), but the PPU used to charge this consumption reconciliation is different. Before embarking on such a large scale change, the CMA would need to be satisfied that the application of SAP to volume is significantly superior to Weighted SAP such that it outweighs the cost of its implementation, remembering that these costs will eventually be met by consumers.

Part 5: Xoserve's Capacity to Deliver the Draft Order

18. npower is concerned that the new UK Link system due to be delivered under Project Nexus will not have the capacity to support a significant increase in the use of Product Class 3. The Nexus Business Requirements Definition document (BRD) estimates peak volume of ten million meter points for Product Class 3, although it is unclear whether this is a daily volume throughput or storage capacity. The BRD implies that a further cost benefit analysis and system design would be required should those initial estimates be insufficient. Clarification is needed from Xoserve as a matter of urgency whether further system changes will be required to accommodate mass movement to Product Class 3 and, if so, the cost of these changes should be included in the cost benefit analysis
19. It is not clear how widely suppliers have developed Product Class 3 functionality and tested it via market trials given that it has been non-mandatory to date. npower notes that there is currently no post Nexus test environment available and as such there will not be a mechanism to carry out any integrated testing with Xoserve for mandatory Product Class 3 functionality. This places further risk on successful delivery of this remedy which should be taken into consideration on timing should this order be implemented. We also note that Xoserve's high

level cost estimate to deliver a test environment was in excess of £2 million and that estimated delivery time was twelve months.⁵ This should be taken into account in the cost benefit analysis and in any decision on timing.

Part 6: Amendments to certain licence conditions

20. Even if the modified requirement to submit batched daily reads were to be appropriate, npower considers that it would more appropriately be dealt with in the UNC and not in supplier licence conditions; licence conditions should set out higher level requirements, with more specific details dealt with in the Code, which allows for greater flexibility and evolution of the market. In light of this and our above concerns about the proposed requirement, we believe a more appropriate route would be for an independent cost benefit analysis to be undertaken through UNC Mod 594R which seeks to review the arrangements and requirements for Shippers to provide reads for Class 3 Supply Points and above where appropriate equipment is installed. The modification workgroup should take into account all costs and assess them against all potential benefits. Although the process for this will take longer than the CMA's current approach, this additional timing is essential to allow for the required analysis, so that the end decision will be founded on a more robust, evidence based platform.
21. npower considers that the regulatory architecture for settlement performance more appropriately sits within the UNC, rather than the Gas Shipper and Supply Licences. The Gas Performance Assurance Framework, which sits within the UNC and will go live alongside Project Nexus, would then have the vires to monitor and set appropriate incentives and targets that are focussed on the actual risks. The draft order requirement for monthly submission of daily granularity undermines the new Gas Performance Assurance Framework and its measures. Despite Performance Assurance targets being agreed and relevant modifications being raised, this order effectively replaces these UNC percentage targets with a Licence condition requirement to meet all reasonable step to submit a daily read. This is a significant increase in the regulatory requirement on read submission and is far in excess of the targets agreed within the industry to correct and ensure data quality.
22. The consultation includes legal drafting for changes to the gas read obligations but fails to recognise the consequential impact on the Smart obligations. Should the CMA proceed with the modified remedy it must provide greater guidance on the consequential changes required.
23. Further the proposed timing fails to recognise the already heavy industry and regulatory demands on supplier systems and which must be delivered in 2017. Should the CMA proceed with the revised remedy implementation that takes into

⁵ Ofgem decision document UNC Mod 531: Provision of an Industry User Test System, section (f) 20 October 2016. <http://www.gasgovernance.co.uk/sites/default/files/UNC531D.pdf>


account the wider industry change landscape along with the impacts on the industry Smart Metering Implementation Plan, the latter of which must take priority.

Part 7: Monitoring and compliance

24. We reiterate the point made in our response to the initial consultation on the draft order that greater clarity is required on what constitutes all reasonable steps. This should include clarification on whether customers who withdraw their consent to provide daily reads should be included under all reasonable steps as well as those premises or meters with technical issues.

Appendices

Appendix 1: Summary of the Nexus Product Classes and related AQ Processes



Annual Quantity BRD

Figure 1: Summary of the 4 meter reading processes and related AQ processes

| Process Description | Read Used for Allocation | Read used for Energy Balancing | Shipper Read Submission | Timing of AQ calculation | Reads used for AQ calculation | Read Type used for the AQ calculation | SOQ Calculation | Reconciliation |
|---|--------------------------|--------------------------------|-------------------------|--------------------------|--|---------------------------------------|-------------------|---|
| Product 1: Daily Metered Time Critical Readings | Daily Read | Daily Read | Daily by 11 am on GFD+1 | Monthly | 2 reads a minimum of 9 months & max of 36 months apart | Actual read | Shipper Nominates | Meter Point level following a re-synch or estimate |
| Product 2: Daily Metered not Time Critical Readings | GT Estimate | Daily Read | Daily by end of GFD+1 | Monthly | 2 reads a minimum of 9 months & max of 36 months apart | Actual read | Shipper Nominates | Meter Point level following a re-synch or estimate |
| Product 3: Batched Daily Readings | Allocation Profiles | Allocation Profiles | Daily Reads in Batches | Monthly | 2 reads a minimum of 9 months & max of 36 months apart | Actual read | GT Derives | Daily Rec at Meter Point level on receipt of a batch of reads |
| Product 4: Periodic Readings | Allocation Profiles | Allocation Profiles | Periodically | Monthly | 2 reads a minimum of 9 months & max of 36 months apart | Actual read | GT Derives | Meter Point level at receipt of read |

Appendix 2: AUGE Interim Table on Unidentified Gas Weighting Factors

| Supply Meter Point Classification | UGS Weighting Factors (by EUC Band) | |
|-----------------------------------|-------------------------------------|--------------|
| | EUC Band 1 | EUC Band 2-9 |
| Class 1 | 0 | 0 |
| Class 2 | 0 | 0 |
| Class 3 | 1.17 | 1.28 |
| Class 4 | 1.17 | 1.28 |