

SSE: RESPONSE TO THE DRAFT GAS SETTLEMENT ORDER

1. Introduction

- 1.1.1 This document provides the response (the *Response*) of SSE plc (*SSE*) to the consultation on the draft Gas Settlement Order (the *Order*) issued on 18 October by the Competition and Markets Authority (*CMA*).
- 1.1.2 Over the course of the Energy Market investigation (*EMI*), the CMA identified a number of inefficiencies in the gas settlements process that were found to have an Adverse Effect on Competition (*AEC*). In its Final Report (*FR*), the CMA recognised that the delivery of Project Nexus will address these inefficiencies and mitigate the AEC for the benefit of customers. SSE has previously explained why it agrees that the delivery of Project Nexus will address inefficiencies in gas settlements in its responses to the Notice of Possible Remedies (*NPR*) and the Provisional Decision on Remedies (*PDR*).
- 1.1.3 In isolation, the amendments to gas settlement currently proposed in the draft Order may provide some marginal improvements in the efficiency of the system. However, it is important to recognise that it is the delivery of Project Nexus in 2017 that will provide the substantial and significant improvements in efficiency for the short and long term benefit of customers. The effect of the Order on the implementation of Project Nexus is detailed below.
- 1.1.4 SSE would support measures that effectively and practicably address the inefficiencies in the gas settlements process identified by the CMA. However, SSE has a number of serious concerns in respect of both the content of the Order and also the consequences of its implementation. It is important that the CMA understands and assesses the effect of implementation and a Summary Impact Assessment is included as Section 2 to this document. In terms of the content of the Order, SSE notes that the CMA has departed from the remedy that was previously consulted on in both the NPR and the PDR. The collection of daily meter readings could be used to improve the gas settlement regime over and above that which is due to be implemented under Project Nexus and we have included our observations on 'Further Reform of Gas Settlement' in Section 3 to this document.
- 1.1.5 The Order seeks to implement a remedy that does not reflect the remedy that was presented in the FR. The remedy prescribed in the FR provided for the collection of Valid Meter Readings on a monthly basis with the Order now providing for these to be collected daily. The change included in the Order imposes a significantly more onerous remedy than that which was previously described, it has never been discussed with SSE and it has not been consulted upon at any stage of the EMI. The CMA has an obligation to consult on proposed remedies in order to ensure that the remedy is proportionate, effective and no more onerous than is necessary for it to achieve its legitimate aim.
- 1.1.6 In considering whether to proceed with any remedy the CMA must consider both its positive and negative outcomes and must pay particular regard to the impact of remedies on customers. The Summary Impact Assessment included in Section 2 demonstrates that there will be a number of unintended consequences of the proposals in the Order. The most serious of these is the detrimental impact the Order will have on the implementation of Project Nexus resulting in a delay in the delivery of the

improved efficiencies in the gas settlements process. Paragraph 2.1.8 also describes how the Order may create a perverse incentive to delay the rollout of smart meters to domestic customers, which is a central plank in the delivery of future customer benefits in the energy sector. SSE's position is that these impacts will have a significant detrimental effect on customers that outweighs any marginal short term beneficial effect of the Order.

- 1.1.7 SSE's analysis demonstrates that the Order is disproportionate with the impact of its implementation having a net detrimental effect on customers. Following consideration of the new remedy proposed in the Order SSE's position is that the CMA should revert to the remedy as proposed in the FR and not proceed with the Order as currently drafted. SSE would welcome an early opportunity to discuss with the CMA this Order and the issues summarised here.

2. Summary Impact Assessment

- 2.1.1 **Project Nexus is the most important reform to gas settlement currently in the pipeline.** Throughout the EMI, the CMA has recognised the transformative effect that Project Nexus will have on the overall efficiency of gas settlement processes. This is recognised in the recommendation that in the FR that Ofgem ensures that Project Nexus is implemented as soon as possible. SSE considers that this recommendation should also cover the implementation of the functionality to provide retrospective adjustment of assets and supply point (**RAASP**), scheduled for delivery twelve months after Nexus go-live.

- 2.1.2 **Early implementation of the Order would jeopardise the effective delivery of significant long term improvements in favour of short term marginal gains.** If the Order were implemented six months after Nexus, it would significantly increase the workload for gas shippers at what will already be a busy time. It is inevitable that this would push the delivery of the RAASP functionality out to an even later date – given that RAASP was always envisaged as an important element of Nexus, this would effectively relegate a far more useful tool in improving the accuracy of gas settlements in order to put a minority of customers into Class 3. SSE is concerned that the section of the Order that seeks to implement monthly reads for Smart Meters from the Project Nexus Implementation date will also increase the volume of reads being processed by Xoserve and divert resources within shipper organisations at the time of Nexus system integration where there will undoubtedly be many unforeseen issues to resolve during the hypercare period, some of which could be business critical and will require full industry attention. Whilst SSE agrees with this part of the remedy it is SSE's opinion that this remedy should be implemented six months after Nexus to avoid disrupting the Project Nexus implementation.

- 2.1.3 There is a huge assumption that all shippers see class 3 as a vital tool and something that gives them major certainties in their settlement allocation. Many companies may not have built it, or if they have, put in place a process that will be initially for a relatively low volume of customers so that they 'can dip their toes in the water' to see the impacts of it.

- 2.1.4 **The Order should not be implemented until *after* the initial peak of reconciliations activity expected following the successful delivery of RAASP.** The implementation of RAASP will be followed by potentially high levels of reconciliation activity. It would be much harder to re-reconcile a significant number

of Class 3 customers for *daily reads* (as under the Order) than to do re-reconciliations on monthly reads (as would have been the case under the remedy presented in the FR). SSE considers that it would be preferable to re-reconcile gas volumes prior to increasing the granularity of meter reads by putting more customers into Class 3.

- 2.1.5 **The Order imposes significant scope creep on Xoserve at a very late stage in the project.** Xoserve will need to test design assumptions and its ability to meet an unexpected and high level of Class 3 customer uptake at a very early stage of the post-Nexus world. This issue might be especially significant if there were huge spikes in meter read submissions which might arise, for example, should all (or just some) shippers choose to send in monthly batches of reads for all of their smart customers on the first working day of the following month.
- 2.1.6 **Industry is ill-prepared for the obligations in the Order.** Very little testing has been done on Class 3 as most shippers had anticipated a gradual transition to this after Nexus go-live, once systems had been proven and any teething problems have been fully resolved. Industry could have no confidence that shippers' and Xoserve's systems are able to deal with the additional burden of larger volumes of data without first conducting further testing – this could further delay or disrupt delivery of Nexus. SSE considers it possible that some shippers may not have even built Class 3 functionality yet, as it was not expected to be required for Nexus go-live. The Order, therefore, represents a very significant new obligation on shippers very late in the day. Having previously expressed some exasperation at earlier delays to the delivery of Project Nexus, it would be contradictory for the CMA to now jeopardise implementation of Project Nexus in order to pursue a small incremental improvement in efficiency.
- 2.1.7 Should the Order be made, as drafted, we feel it is unrealistic to perform testing between the Nexus Implementation date and the end of the hypercare period, when the industry will be focused on resolving defects arising from Nexus, but that peer to peer testing should be undertaken for daily read functionality as part of the Nexus testing programme. The Xoserve systems must be subject to full volume testing to ensure that they can meet all volumetric requirements in any scenario for when shippers choose to send in their batches, which could be in monthly batches all on the same day. Industry must have confidence that Xoserve will, in a relatively short space of time, be capable of handling circa 25 million batches of 31 reads on a single day and processing all subsequent reconciliations and other associated processes. Without this testing there can be no confidence that the introduction of this Order soon after Nexus implementation won't lead to a catastrophic failure of the new systems very soon after the hypercare period has been exited. The only logical conclusion that allows the necessary testing to take place is that the Nexus testing period must be prolonged which will lead to a delay to Nexus Implementation.
- 2.1.8 **There are diminishing returns in terms of improvements to efficiency in requiring ever more granular meter reads.** Daily reads would remove the shape error in settlements that an annual read only would entail. However, the improvement is marginal given that: the aggregate daily customer demand will be close to the daily profiles used; average daily variations in gas prices over a month are not that large (as commodity prices exhibit mean reversion); monthly reads would provide a similar benefit by also correcting for most of this shape error. Furthermore, the rolling AQ process will be just as accurate and updated just as often with a monthly read as it

would be based on a monthly process (utilising daily reads). This observation would actually support the monthly readings that the CMA proposed in the FR.

- 2.1.9 **The decision to require daily meter reads did not have regard to all relevant information.** Ofgem informed the UNC Distribution Workgroup, that it had requested the CMA amend the remedy to require meter reads as this was likely to become a mandatory requirement at some point in the future in any case. However, analysis carried out to inform the development of the Performance Assurance Framework (*PAF*), concluded that monthly reads were sufficiently granular to address any concerns regarding the accuracy of gas settlements. Ofgem is fully aware of this analysis as it has followed the progress of the PAF.
- 2.1.10 The Order also has the effect of undermining the work of the Performance Assurance Committee which considers risk and settlement issues and whose aim is to reduce the risk and allocation under Nexus by implementing performance targets and behaviours that will benefit the whole industry. Ofgem attend the monthly meeting of this committee and SSE would strongly argue that any future changes to settlement behaviour should be made through this committee in a timely, considered manner, with experience and where most if not all of the industry supports such measures, with agreed measurements and metrics in place.
- 2.1.11 **The CMA has not considered the implications for the rollout of smart meters.** The Order may create a perverse incentive for suppliers to back-load the rollout process to postpone the more onerous Class 3 obligations. Equally, customers with smart meters have the right to restrict readings to monthly rather than daily granularity, limiting any perceived benefits of the more onerous obligation.
- 2.1.12 **It is inadvisable for the CMA to implement this Order without properly assessing its impact.** No business case, cost benefit analysis or impact assessment has been carried out – this introduces unnecessary additional risks during a period of major industry change. The benefit to daily read submission over monthly submission is minimal as demonstrated by an Engage Consulting report independently commissioned by Ofgem; and is considerably lower than the costs and risks that would be involved with implementing this remedy for the whole industry 6 months after Nexus Implementation. The Engage Consulting report listed 15 key settlement risks and the risk that the Order seeks to remedy was only number 12 on the list.
- 2.1.13 **The Order is disproportionate and ignores the more efficient and less onerous option of requiring monthly reads, which was properly consulted upon during the EMI.** The initial CMA recommendation that suppliers obtain monthly reads and then pass these via relevant shippers for submission under product class 4 is viable. Ideally this remedy would have been implemented via a small change to the UNC to alter the maximum read submission frequency for annually read customers, rather than as an obligation on suppliers (who are not party the UNC and who do not need to comply with the requirements of Section M, as this is, in fact, an obligation for gas shippers). As such, SSE considers that the proposed amendments to licence conditions are revisited to avoid unnecessary confusion between supplier and shipper duties and obligations.

3. Further reform of Gas Settlement

- 3.1.1 The driver, in part, for the Order seems to be a desire to further reform the gas settlement regime to align it with the electricity settlement model, which is moving to a half hourly settlement, with a view being taken that ‘if electricity can do it half-hourly then gas should be able to do it daily’. This, on the surface, seems a valid viewpoint. However, the project to move all electricity customers to half-hourly settlement has a number of key differences over the Order.
- 3.1.2 The electricity change is being made on established systems that have been operational and stable for a number of years, it is being managed under an established project, under proper project governance and is also being rolled out in phases rather than in one go. The Gas Settlement Order is a blunt instrument with no project governance around it that could, as a result, have very large unforeseen consequences in new systems. Gas settlements is a ‘zero sum game’ with any changes to the regime resulting in potential winners and losers in equal and opposite amounts. Therefore, any gas settlement changes tend to have supporters or opponents, depending on their view of the effects of the changes, or fairly universal support where there is a perceived lowering of the risk to all parties, and hence an elimination of the size of the errors that can result in losers and winners which Project Nexus will provide. The Order is unlikely to have positive effects on customer tariffs and could end up leading to upward pressure on them as it will increase overall Industry costs over and above the benefits or lowering of risk
- 3.1.3 The whole settlement process has been produced, including the rolling AQ, on the proviso that a majority of gas will be settled on class 4, where reads are taken monthly for smart meters. There is a very strong argument that with daily reads coming into settlement that the initial allocation of customers could be made more accurate by making initial gas allocation calculations based on something that is not a standard profile but more fitted to each individual customer’s shape. A classic example of this is pre-payment customers where a modification was passed some time ago to reallocate energy so that shippers supplying these customers had a different profile allocated to them giving a lower gas allocation in winter and a higher allocation in summer. Whilst monthly reads will improve the situation, the fact that the prepayment shape is not ‘typical’ of the standard profile, suppliers to these customers are likely to be further out of balance on reconciliations and have to buy more gas than they need in winter and less in summer and so be subject to more costly imbalance costs, thus increasing costs for what are generally perceived as poorer customers. Sending in daily reads will not help this situation as the initial allocation is where the error is and this will not change under rolling AQ whether the readings are sent in monthly or daily. However, the daily reads could be used under a revised settlement regime to, for example, change the initial allocation to these customers and possibly place more importance of demand on initial customer allocation based on recent months, as is done under the EAC/AA process in electricity rather than a flat AQ process in gas which bears no relation to actual different customer demand shapes.
- 3.1.4 Whilst it may be disappointing to state this shortcoming given that the Nexus systems have not yet gone live, the logical conclusion with the receipt of daily reads for all customers is that the whole settlement model could be looked at to improve accuracy which could lead to a far better gas settlement process. This could be further extended to more accurately charge shippers based on actual SOQ values rather than them being derived from AQ values, and to shorten the length of the gas

reconciliation period and to make it more akin to electricity, which also will reduce risk and hence any premiums for this built into customer tariffs.

- 3.1.5 A bigger error in the gas settlement process is unidentified gas which the AUGE process seeks to address. This was identified in the Engage report. Monthly readings will ensure that all unreconciled energy will be reconciled. However, even with daily readings going into Settlement unallocated energy will never be correct. This area has always allocated more energy to the SSP sector than the LSP sector and we would welcome more controls in this area prior to the introduction of the new AUGE to ensure that all unallocated energy is allocated on a more equitable basis. We see this as being far more important than reconciling all known energy on a daily basis so that domestic customers are not disadvantaged in the future as they have been under the current gas settlement regime.