



To: Gas Distribution Networks

*Promoting choice and value for  
all gas and electricity customers*

31 July 2012

Dear Colleague

### **Open letter to Gas Distribution Networks on Project Nexus gas settlement reforms**

This letter sets out Ofgem's expectations for gas settlement reform and invites further information, in the form of detailed plans, to provide assurance that reform will be delivered and expectations will be met.

We are monitoring progress on gas settlement reform as part of our strategy for promoting smarter energy markets.<sup>1</sup> Today, in a related document, we have published an initial work programme setting out how changes necessary to enable market development should be progressed.

#### **Context**

For the vast majority of customers, the gas settlement arrangements do not provide an ongoing accurate link between a consumer's consumption and their supplier's charges. This can result in some consumers paying more than they should, and others paying less. It can also distort competition between suppliers and represent a barrier to entry. Gas transporters have a duty under the Gas Act 1986 to facilitate competition in the supply of gas.<sup>2</sup> We consider that a well-functioning settlement system is an important contribution to the performance of this duty.

Industry has committed significant time and effort to the development of reform options through the Project Nexus workgroup. However, while this work has been constructive, progress has been slow. Settlement systems have remained largely unchanged since the start of domestic competition. This is despite Gas Distribution Networks (GDNs) being provided with funding for replacement systems under GDPCR 2007-13. While to some extent the timing of system changes has been affected by uncertainty over plans for smart metering, this source of uncertainty has been substantially removed as a result of government policy decisions over the past 18 months.

The roll-out of smart and advanced metering provides an opportunity to improve settlement through access to accurate and timely meter reads. The roll-out across both domestic and non-domestic consumers is planned to be substantially complete by the end of 2019. Settlement systems therefore need to be 'smart ready' as soon as possible.

In December 2011, Ofgem consulted on the scope of a strategy to promote smarter energy markets from the platform of smart metering. Our core contention was that without

<sup>1</sup> *Promoting smarter energy markets: a work programme*, Ofgem, July 2012.

<sup>2</sup> Section 9, paragraph 1A.

changes to existing market arrangements, the potential for market development would be constrained. Gas settlement is a key area where we have identified that reform is needed to facilitate market development in the interests of consumers. Effective use of data from smart meters is likely to increase accuracy in the allocation of industry charges, reduce costs and provide a platform to offer new and innovative products to consumers. Given the work already being undertaken by the Project Nexus, we do not consider that this as an area where Ofgem, at this stage, needs to lead a process for delivering change.

## **Our expectations**

Based on our assessment of the current position, we consider that it is reasonable to expect the following in respect of the reform of gas settlement:

- New systems in place and operational by end-2015<sup>3</sup>, which (a) substantially improve the accuracy of the settlement process based on existing meter data availability, and (b) are capable of making effective and efficient use of smart and advanced meter data as its availability increases over time.
- A fully-resourced commitment to the delivery of the above on the part of both GDNs and users of settlement systems, including in the development and presentation of rigorous analysis to support any required changes to industry codes.
- A robust, transparent and well-managed plan with regular reporting against milestones, and effective engagement with stakeholders – including Ofgem. The plan should provide for effective, efficient and co-ordinated analysis of options.
- A robust framework for the assessment of proposals that can take account of potential changes to the governance and funding of Xoserve over the same period.<sup>4</sup>

Ofgem is committed to playing its part in ensuring that these expectations can be met, but we see primary responsibility and accountability residing with GDNs.

Shippers and suppliers also have an important role in defining the scope of the changes and assessing the costs and benefits of these settlement reform proposals. To this end, we would expect suppliers and shippers to commit resource to developing the proposals under Project Nexus and supporting their robust assessment.

We note that a significant risk to the aim of delivering settlement reform by the end of 2015 is the potential for shippers to raise alternative proposals late in the UNC modification process. We hope that you will join us in urging shippers to confirm, as a matter of urgency, if they intend to raise any alternative proposals. Such alternatives can then be considered and their assessment built into the project plan.

As set out in the initial work programme published today, we will consider the scope for longer-term reform to the gas settlement arrangements once any Project Nexus modifications have made significant progress towards implementation. The aim of this approach is to avoid diverting resource away from existing work being undertaken to improve settlements through Project Nexus. Nevertheless, we recognise that further improvements may be needed in the longer-term to unlock the full benefits of smart metering. Given the potential for future change, we would welcome the importance of flexibility being recognised as a desirable characteristic for the proposed replacement of the UK-Link systems to help minimise the cost and implementation timescales.

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<sup>3</sup> This is in line with the timetable developed by Xoserve and presented to the Project Nexus workgroup.

<sup>4</sup> On 18 July we issued an Invitation to Provide a Proposal (IPP) for consultants to support the development of detailed governance and funding rules for Xoserve. Our aim is to consult on the options for reform in February 2013, with detailed licence proposals to follow in June 2013. We note the potential impact of the design of these funding arrangements on any assessment on costs.

**Next steps**

We invite you to submit a project plan, which includes details of the development of robust modification proposals, that you, together with the other GDNs, propose to commit to and resource with the aim of achieving settlement reform by end-2015.

If you would like to discuss these issues further, including how we have characterised our expectations, then please contact Andrew Wallace ([andrew.wallace@ofgem.gov.uk](mailto:andrew.wallace@ofgem.gov.uk); 020 7901 7067). I look forward to your response.

Yours sincerely

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