

Modification proposal:	Uniform Network Code (UNC) 550: Project Nexus - Incentivising Central Project Delivery		
Decision:	The Authority ¹ has decided to reject this proposal		
Target audience:	UNC Panel, Parties to the UNC and other interested parties		
Date of publication:	27 May 2016	Implementation date:	Not applicable

Background

The UK Link system, operated by Xoserve for energy settlements, supply point administration and other functions for the Great Britain gas market, is scheduled to be replaced. Project Nexus aims to ensure that the replacement systems meet the current and anticipated requirements of market participants and that these participants have updated their own IT systems to interface with the new Xoserve systems. The principal UNC modifications that will give effect to these changes are:

- UNC432², which will reform the gas settlement arrangements; and
- UNC440³ which will extend the industry standard customer switching arrangements to independent Gas Transporter (IGT) connected customers.

These and other modifications associated with Project Nexus are scheduled to be implemented together on the Project Nexus Implementation Date (PNID). The PNID was originally scheduled to be 1 October 2015, but subsequently deferred as part of UNC548⁴ to be 1 October 2016 or such other date as may be determined by the Authority.

UNC548 arose following consideration of a report by the independent project assurance manager, PricewaterhouseCoopers (PwC), showing that 1 October 2015 was no longer a viable implementation date for the Project Nexus modifications. This was based on an assessment of GT and shippers' planning and state of readiness at that time, which, amongst other things suggested that there was insufficient provision for systems testing ahead of scheduled market trials. Given the potential risk to consumers and industry parties, we accepted the recommendation of the Project Nexus Steering Group (PNSG) that implementation be delayed in order to allow robust systems testing and market trials, culminating in a revised implementation date of 1 October 2016. We accepted UNC548 on 13 August 2015.

The modification proposal

UNC550, which was proposed by RWE npower in August 2015, seeks to introduce an incentive payment scheme that may be triggered in the event of the Authority directing the PNID to be later than 1 October 2016. Specifically, if the delay is determined to be the result of a failure on the part of one or more of the GTs, a payment would be made in favour of Shippers and a suitable charity to be nominated by the GTs. The payment would be for a value of £5m for each month of the delay, capped to a maximum of £10m.

UNC Panel recommendation

Some panel members considered that if UNC550 proved to be an effective means of achieving the PNID it would further facilitate relevant objective (f). Other members did

¹ References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.

² UNC432: '[Project Nexus – gas settlement reform](#)'

³ UNC440: '[Project Nexus – IGT Single Service Provision](#)'

⁴ UNC548: '[Project Nexus – deferral of implementation date](#)'

not consider that the proposal would have such an effect, and that it may also have a detrimental effect on how UNC parties may approach future change.

The majority vote of the Panel, with six of eleven votes in favour, was to recommend the implementation of UNC550.⁵

Our decision

We have considered the issues raised by UNC550 and the Final Modification Report (FMR) dated 17 March 2016, including the consultation responses published alongside that FMR.⁶ We have concluded that the implementation of UNC550 will not better facilitate the achievement of the relevant objectives of the UNC.⁷

Reasons for our decision

We note that the UNC Panel vote broadly mirrored the consultation responses, with eight of the fifteen respondents being in favour of implementing UNC550, with another offering qualified support. The UNC GTs made up five of the six respondents who were opposed to UNC550 being implemented.

As the focus of UNC550 is on the timely delivery of the Project Nexus modifications previously directed for implementation, we agree with the UNC Panel and those respondents who considered that it should be considered against relevant objective (f) only. We consider that it would have a neutral impact on the other relevant objectives.

(f) the promotion of efficiency in the implementation and administration of the Code

We are sympathetic to the intent of UNC550 insofar as we also want to ensure that Project Nexus is implemented as soon as practicable, given the benefits it offers for consumers and competition (as set out in relevant modification decision letters), and because it has already been the subject to significant delay. However, it is critical that consumers are not negatively affected by Nexus and they experience a seamless transition from legacy to new arrangements.

In recognition of the potential risks to consumers if there is a failure in the implementation of the new IT systems, earlier this year we took on a formal sponsorship role for Project Nexus.⁸ To support us in this role, we extended the mandate of PwC to provide an integrated programme management function and expand its assurance role to include Xoserve's and the GT's preparations, as well as those of IGTs and shippers. We have also been clear that we will only allow the Project Nexus systems to go live once we are confident that the risks to consumers have been appropriately mitigated. It is in the context of balancing timeliness of implementation against the risk to consumers that we have considered the relative merits of UNC550.

Effectiveness

⁵ UNC Panel voting record: www.gasgovernance.co.uk/sites/default/files/Minutes%20and%20Voting%20Record%20panel%20187%20170316%20v1.0.pdf

⁶ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.co.uk/0550

⁷ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=6547

⁸ www.gasgovernance.co.uk/sites/default/files/Ofgem%20Open%20Letter%20on%20Project%20Nexus%20and%20Ofgem%20sponsorship.pdf

Whilst the majority of respondents consider that UNC550 would improve the incentives on GTs to meet the PNID, there were no suggestions as to what further action respondents expected GTs to take. GTs for their part argued that they were already incentivised to deliver Project Nexus in a timely fashion, both in terms of meeting their UNC obligations, underpinned by licence, and also the fact that they would also incur costs as a result of any delay, which they are unable to pass through.

We see no reason in principle why incentive arrangements could not be developed for IT projects undertaken under UNC governance in much the same way as can be found with other infrastructure projects in the gas and electricity industry, and contracts more generally. However, we agree with those respondents who suggested that such incentives must be properly designed and introduced at a timely point, or they may not drive the desired behaviours. The threat of a liability payment may also create perverse incentives insofar as defects or other issues may not be properly reported and addressed. Ultimately, it would be consumers that would suffer in such an event.

Given the above, we are not convinced that UNC550 would drive new behaviours that would have a positive impact on the programme, particularly coming so late in the overall development of Project Nexus and so close to the scheduled PNID. Moreover, success must be considered against the impact on consumers. We are concerned that UNC550 may create perverse incentives, for instance in proceeding without addressing material defects in order to hit 1st October implementation date, which increase the risk to successful implementation. It would expose consumers to additional risks such as problems with the change of supplier or supplier billing processes. Ensuring that consumers have a positive experience of, and have trust in, the switching process is key to driving market engagement and creating competitive tension which improves outcomes for consumers.

Enforceability

Whilst we recognise the efforts that the UNC550 workgroup made in trying to determine an appropriate figure for, and method of distributing, the incentive payment it is not clear that the £5m per month figure bears any direct relation to the loss that parties may incur as a result of any delay. This would be compounded by the complexity of distributing this payment amongst affected shippers. As noted by the one shipper respondent who was opposed to UNC550, the costs that any delay to the PNID may impose upon shippers is not necessarily proportionate to their market share. Therefore any payment they may be due to receive under UNC may bear no direct relation to any loss they might incur.

There is also a clear disagreement amongst parties on the principle of the proposed incentive payment, let alone the relevance of the £5m per month liability. We are concerned that these factors, combined with the timing issues set out above, mean that UNC550 could be construed as a penalty clause and therefore unenforceable under law.

Conclusion

At the highest level, Project Nexus will be successful if it delivers a fit-for-purpose gas settlement solution that supports industry requirements, is stable and sustainable and enables a positive consumer experience. As the Competition and Markets Authority has identified, Project Nexus has the potential to correct an Adverse Effect on Competition in the gas market and deliver better outcomes for consumers through the use of smart meter data for settlement.

However, as with any IT-enabled transformation of this scale, there are significant risks of problems occurring during its implementation. Indeed, as a multi-party programme involving every shipper in the GB market, who need to ensure their own IT upgrades are built and tested so they are ready for a synchronised, whole market go-live, these risks

are particularly acute for Project Nexus. The successful implementation of Project Nexus will therefore require a concerted effort by all relevant parties. No single contributing factor led to the PNID being delayed from 1 October 2015 and any future assessment on whether or not the systems are ready to be implemented will similarly need to be considered in the round.

An implementation problem could have significant impacts on the operation of the market. The effects would be directly felt by consumers, for example they may be unable to switch supplier or face billing issues as shippers are unable to settle their gas volumes. Given this, we consider Project Nexus to be one of the biggest risks to consumers in 2016. We will shortly publish PwC's independent report on the status of the programme and the activities needing to be undertaken by market participants in order to be ready for the systems to go live with an acceptable level of risk to consumers. This holistic review, rather than the activity to date of any individual party or group of parties, will inform whether 1 October 2016 remains the appropriate PNID.

Rob Salter-Church

Partner, Consumers and Competition

Signed on behalf of the Authority and authorised for that purpose