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Dear Jonathan,

Ofgem recommendation regarding UNC modifications 0642 and 0642A: 'Changes to settlement regime to address Unidentified Gas issues'; and 0643: 'Changes to settlement regime to address Unidentified Gas issues including retrospective correction'.

Thank you for the opportunity to respond to Ofgem's position to agree with the UNC Panel recommendation to reject the proposed UNC modifications 0642, 0643, and 0642A.

This response is made on behalf of National Grid NTS and, as detailed in our response to the final workgroup report, although we appreciate UIG is causing challenges for the industry, we do not support these Modifications, as we do not believe they better facilitate the UNC relevant objectives. We therefore support Ofgem's recommendation to reject UNC modifications 0642, 0643, and 0642A.

Our more detailed response to Ofgem's consultation regarding their decision is included below. If you wish to discuss any element of our response, please do not hesitate to contact me.

Yours sincerely,

Angharad Williams

Commercial Analyst
Market Change Gas

1. **Do you consider that we have appropriately identified and where possible quantified the impacts of the proposals?**

Effect on relevant objective (d)

National Grid NTS considers that Ofgem has appropriately identified and quantified the impacts of the proposed UNC modifications 0642, 0643, and 0642A.

Each of the proposals were assessed in regard to UNC relevant objective (d): the securing of effective competition between relevant shippers and suppliers, both by the modification proposers, and by the respondents to the final workgroup report consultation.

National Grid NTS is in agreement with Ofgem that all three proposals would not better facilitate relevant objective (d), and may have a negative effect on competition.

In the CMA's Energy Market Investigation final report, it identified the pre-Nexus gas settlement arrangements, including those relating to the allocation of UIG, as contributing to an adverse effect on competition.

Therefore, the suggestion of modifications 0642 and 0643 to 'return the market volatility to pre-Nexus levels' would undo years of work and investment by the industry into establishing the revised balancing regime introduced as part of Nexus, which was seen as a necessary and progressive step.

Whilst we understand that some parties are experiencing challenges with the revised regime, and that refinements may be necessary as we progress and the new regime embeds, we agree with Ofgem that the solutions outlined in 0642 and 0643 would not be a progression as they are likely to reduce transparency, and return the balancing regime to pre-Nexus arrangements.

Whilst modification 0642A doesn't propose a return to the arrangements pre-Nexus, we still feel it doesn't further relevant objective (d), and would increase costs to the industry. This is because each of the proposals recommend that Daily Metered (and non-Daily Metered for 0642A) supply points make a fixed UIG contribution. This would expose certain shippers to costs where they may not have otherwise incurred them, for example this might be the degree of the cost incurred on days where UIG is positive, or on days where UIG is negative and they should be receiving credits.

Consistent with Ofgem, we also note that, although the proposals may provide greater predictability in regard to shipper's UIG contribution (for Daily Metered supply points in 0642 and 0643, and also non-Daily Metered in 0642A), the gas must be allocated somewhere, so the volatility would just be directed elsewhere within the balancing regime.

Retrospective effect

We share Ofgem's concerns regarding the retrospective application of modification 0643, and that this would introduce considerable uncertainty and have material financial implications. It would, in effect, be undoing all the UIG allocations that have occurred since its suggested effect date of 1 June 2017.

We are also concerned that modification 0642 would have a degree of retrospective application, as it is intended to take contractual effect prior to the necessary systems changes being made. This would also introduce additional uncertainty, and therefore risk and complexity, to the market, as participants would be balancing their portfolios to a regime different to the position visible in the Gemini system for a considerable period.

We note that this may cause the system to be out of balance and could impact the residual balancer as the system would not be aligned for a further period of circa 46 weeks after implementation (based upon Xoserve implementation estimates).

Cost implications

We would like to highlight that there are substantial costs to implement the modifications (£1m - £2.2m based upon estimates provided by Xoserve), with a large proportion of this attributable to Gemini system changes and associated market trials. Should any of these modifications be implemented, we would require careful consideration of the apportionment of these costs to be considered by the DSC Change Committee under 4.1 of the DSC Change Management Procedure, as National Grid NTS is not a beneficiary of the changes proposed and we consider that the principle that beneficiaries should pay for change needs to be applied in this case.

Also, the proposed modifications would have no direct demonstrable benefit to the consumer. They will not reduce the overall levels of UIG in the market, just change the distribution of the costs. As consumers (along with gas transporters) have already paid for an expensive Nexus system, the costs associated with the systems changes proposed in the modifications would be an additional cost for the consumer with no direct value for them.

Preferred approach

We agree with Ofgem that a preferred approach would be to incentivise the market to address the underlying issues of UIG, by concentrating on approaches which would improve the underlying data and calculations associated with the settlement regime. We note that Panel recently recommended the implementation of Modification 0658, to introduce a new CDSP led taskforce to investigate the drivers behind UIG, as well as proposing process and system improvements to address the UIG issues being experienced, which we believe will bring a welcome additional level of focus and rigour around understanding the challenges the market is facing with UIG.