

# 0571:

## Application of Ratchets Charges to Class 1 Supply Points Only



Recognising the introduction of 4 new classes of Supply Points under Project Nexus and the wider availability of daily read sites with lower AQs, this modification limits the application of Ratchets Charges to Class 1 Supply Points whose operation may be material to the safe operation of the Network.

	The Workgroup recommends that this modification should now proceed to consultation.
	High Impact: Shipper Users and Transporters
	Medium Impact: None
	Low Impact: None

Contents		 Any questions?														
1	Summary	3														
2	Why Change?	4														
3	Solution	4														
4	Relevant Objectives	5														
5	Implementation	6														
6	Impacts	6														
7	Legal Text	6														
8	Recommendation	6														
9	Appendix 1 – Ratchet Charges	7														
10	Appendix 2 – Options for consideration	8														
<b>About this document:</b>		 enquiries@gasgovernance.co.uk														
<p>This report will be presented to the panel on xx xxx 2016.</p> <p>The panel will consider whether the modification should proceed to consultation or be returned to the workgroup for further assessment.</p>		 0121 288 2107														
<p>The Proposer recommends the following timetable:</p> <table border="1"> <tbody> <tr> <td>Initial consideration by Workgroup</td> <td>28 January 2016</td> </tr> <tr> <td>Amended modification considered by Workgroup</td> <td>28 April 2016</td> </tr> <tr> <td>Workgroup Report presented to Panel</td> <td>16 June 2016</td> </tr> <tr> <td>Draft Modification Report issued for consultation</td> <td>16 June 2016</td> </tr> <tr> <td>Consultation Close-out for representations</td> <td>08 July 2016</td> </tr> <tr> <td>Final Modification Report presented to Panel</td> <td>11 July 2016</td> </tr> <tr> <td>UNC Modification Panel decision</td> <td>21 July 2016</td> </tr> </tbody> </table>		Initial consideration by Workgroup	28 January 2016	Amended modification considered by Workgroup	28 April 2016	Workgroup Report presented to Panel	16 June 2016	Draft Modification Report issued for consultation	16 June 2016	Consultation Close-out for representations	08 July 2016	Final Modification Report presented to Panel	11 July 2016	UNC Modification Panel decision	21 July 2016	Proposer: <b>Steve Mulinganie</b>
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# 1 Summary

## Is this a Self-Governance Modification?

This is not considered to be a Self-Governance modification because it is expected, for the customers impacted, to have a material impact on the commercial activities connected with shipping gas.

## Is this a Fast Track Self-Governance Modification?

Fast Track procedures do not apply because it is not a housekeeping modification.

## Why Change?

The industry is rolling out Smart and Advanced metering across the entire market allowing Shippers, Suppliers and Customers ready access to more granular consumption information remotely. At the same time Project Nexus is introducing new customer classes. These new classes (1 to 4) allow market participants the ability to provide more granular consumption (read) data into central systems thus driving more accurate and targeted settlement. When considering the proposed arrangements for market operation post Nexus Go Live and potential disincentives to use more granular Classes the application of Ratchet Charges in Class 2 seems disproportionate considering the potential future utilisation of this class by a wide range of customers, including domestic consumers, other than mandatory Class 1 customers. We therefore propose to limit Ratchets Charges to Class 1

## Solution

Our proposed solution is that Ratchets Charges should only apply to Class 1 Supply Points .

## Relevant Objectives

We believe this modification enhances competition between Shippers because it ensures that the behaviour ratchets charges incentivise is targeted only at larger consumers (relevant Class 1 Supply Points), whilst removing a potential disincentive for the broader utilisation of Class 2.

## Implementation

No implementation timescales are proposed. However we would expect this modification to be implemented in line with Project Nexus Go Live if practicable. We would also note that Class 4 or 3 consumers who transfer to Class 2 are automatically afforded protection from Ratchet charges for the 1<sup>st</sup> year and so implementation could delayed till Nexus Go Live + 1 year should this be more achievable.

## Does this modification impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

This modification impacts Project Nexus but only in a very limited way as it removes the applicability of Ratchets charges from Class 2 Supply Points. To avoid any form of retrospection we would like to see this modification implemented in time for Project Nexus Go Live.

## 2 Why Change?

A description of ratchet charges is included for completeness in Appendix 1.

The market is at the threshold of major change with a number of significant projects coming into effect as well as new initiatives such as next day switching being developed. The industry is rolling out Smart and Advanced metering across the entire market allowing Shippers, Suppliers and Customers ready remote access to more granular consumption information. At the same time Project Nexus is introducing rolling AQ and new customer classes (Class 1 to 4) which allow market participants the ability to provide more granular consumption (read) data into central systems thus driving more accurate and targeted settlement. In the Power market the Government is proposing that all consumers should be settled on 15 minute data.

When considering the proposed arrangements for market operation post Nexus Go Live the relevance of the application of Ratchet Charges in Class 2 seems disproportionate considering the potential utilisation of this class by a wide range of customers, including domestic customers, other than traditional DM customer's i.e. very large industrial process customers. These potential future Class 2 customers do not materially impact the operation of the Network and thus no justification exists to expose such customers to penal ratchet charges.

It is worth noting that Ratchets do not apply in the summer and thus if the Ratchet Charge was to protect against optimisation we may expect to see wholesale under booking of SOQ during the summer as these customers are not seasonal users albeit their base loads may be impacted by ambient temperatures to a certain extent.

The fact that the Ratchet regime only operates in the winter clearly identifies its purpose as managing over utilisation of capacity when the system is more likely to be constrained and not addressing the risk of optimisation.

It is also worth noting that only sites whose AQ is greater than 2m therms per annum are mandated to be daily read (Class 1) and thus must fall within the scope of the Ratchet regime. All other sites can be non-daily metered were Ratchets do not apply.

If parties did optimise the SOQ in Class 2 then the daily read requirement for such sites would mean any "benefit" would be effectively [1] day as the SOQ will always ratchet up to the actual SOQ

Any error arising out of the under booking of the SOQ would create issues in terms of balancing and imbalance risk and charges and ultimately the disconnect would be corrected at reconciliation

Recognising the potential wide scope of customers able to readily utilise Class 2 services we need to consider the relevance of the penal Ratchet Charge regime in this Class. We believe the historic concerns which justified the argument for penal Ratchet Charges for large industrial process loads does not apply to customers who may wish to elect in to Class 2. As such these customers operations do not materially impact the operation of the Network to the extent that they justify penal ratchet charges. We therefore propose to limit Ratchet Charges to Class 1,).

## 3 Solution

Our proposed solution is that Ratchets Charges should be limited to Class 1 Supply Points only. UNC TPD B 4.7 should be amended to limit the scope of Ratchet Charges to Class 1 Supply Points

Having considered the options within the workgroup (see paper attached as Annex 2) on how to best achieve this goal we believe the **Application of Ratchets without penalties** for Class 2 Supply Points (Option 2 in the paper) is the appropriate solution.

User Pays	
Classification of the modification as User Pays, or not, and the justification for such classification.	This is a proposed amendment to an existing ratchet incentive regime as it is proposed to restrict Ratchets Charges to Class 1. No new User Pays service is being created.
Identification of Users of the service, the proposed split of the recovery between Gas Transporters and Users for User Pays costs and the justification for such view.	All Users with Supply Points other than Class 1 could benefit from the potential to easier access Class 2 arrangements and costs would be recharged on the basis of eligible Supply Points
Proposed charge(s) for application of User Pays charges to Shippers.	<i>To be confirmed</i>
Proposed charge for inclusion in the Agency Charging Statement (ACS) – to be completed upon receipt of a cost estimate from Xoserve.	<i>To be confirmed</i>

## 4 Relevant Objectives

Impact of the modification on the Relevant Objectives:	
Relevant Objective	Identified impact
a) Efficient and economic operation of the pipe-line system.	None
b) Coordinated, efficient and economic operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters.	None
c) Efficient discharge of the licensee's obligations.	None
d) Securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers.	Positive
e) Provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards... are satisfied as respects the availability of gas to their domestic customers.	None
f) Promotion of efficiency in the implementation and administration of the Code.	None
g) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.	None

This modification ensures that the behaviour Ratchets incentivise apply only to the largest consumers and that, as a result, Class 2 will be available without the disproportionate impact of the Ratchet regime being applied to those Supply Points, which as Advanced and Smart metering rollout continues will become available to more consumers with lower levels of consumption, therefore it is securing effective completion between Shipper Users and furthering Relevant Objective d).

## 5 Implementation

No implementation timescales are proposed. However, it is anticipated that this modification could be implemented in line with Project Nexus Go Live.

## 6 Impacts

### Does this modification impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

This modification impacts Project Nexus but only in a very limited way as it removes the applicability of Ratchets Charges from Class 2 Supply Points. We would also note that Class 4 or 3 consumers who transfer to Class 2 are automatically afforded protection from Ratchet charges for the 1<sup>st</sup> year and so implementation could be delayed till Nexus Go Live + 1 year should this be more achievable.

## 7 Legal Text

### Text Commentary

Insert text here

### Text

The following Text has been prepared by National Grid Distribution and no issues were raised by the Workgroup regarding its content.

## 8 Recommendation

The Proposer invites the Panel to:

- Determine that this modification should not be subject to self-governance; and
- Progress to Workgroup assessment.

## 9 Appendix 1 – Ratchet Charges

### What is a Ratchet?

Put simply a ratchet is a commercial penalty charge applied to any daily metered meter which during the Winter Period (October to May) exceeds its agreed Daily Capacity (SOQ). This commercial penalty exists to deter parties from setting their daily capacity requirements below what is actually needed during the winter when demand is at its highest.

### Current Process Overview

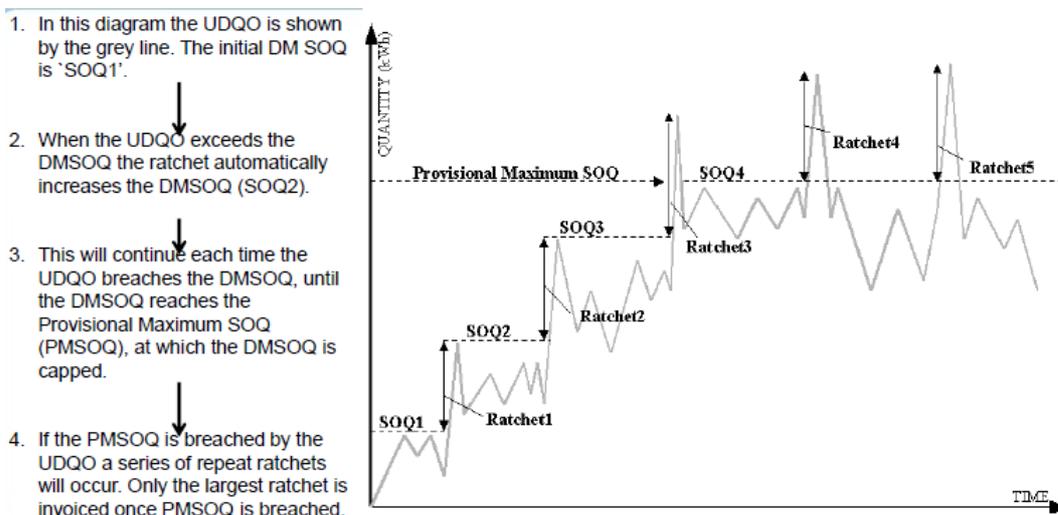
When a Shipper takes ownership of a supply point they must nominate a Daily Supply Point Offtake Quantity (SOQ), which must not be less than the Bottom Stop SOQ (BSSOQ), the maximum daily amount off-taken in the previous winter period. Should the User Daily Quantity Off-Take (UDQO) exceed the booked capacity, a ratchet will occur. The ratchet acts as both a commercial incentive as well as increasing the SOQ to the new peak off-take, subject to the provisional maximum SOQ for the Supply Point.

Ratchets are applicable to Daily Metered Supply Points, or the Daily Metered component within a mixed Supply Point.

### Ratchet Calculation

In the case where the UDQO exceeds the DM SOQ, the difference is used to calculate the ratchet charge. UNC Section B4.7.6:

- The Supply Point Ratchet Charge shall be calculated as the Capacity Ratchet Amount multiplied by the sum of:
  - (a) 2 times the Applicable Annual Rate (including where determined in accordance with paragraph 1.8.5(a)) of the LDZ Capacity Charge; and
  - (b) where applicable, 2 times the Applicable Annual Rate of the Capacity Variable Component (if any) of the Customer Charge



1. In this diagram the UDQO is shown by the grey line. The initial DM SOQ is 'SOQ1'.
2. When the UDQO exceeds the DMSOQ the ratchet automatically increases the DMSOQ (SOQ2).
3. This will continue each time the UDQO breaches the DMSOQ, until the DMSOQ reaches the Provisional Maximum SOQ (PMSOQ), at which the DMSOQ is capped.
4. If the PMSOQ is breached by the UDQO a series of repeat ratchets will occur. Only the largest ratchet is invoiced once PMSOQ is breached.

Abbreviation	Definition
DMSOQ	Registered DM Supply Point Capacity
PMSOQ	Provisional Maximum Supply Point Capacity
UDQO	User's Daily Quantity Off-taken
BSSOQ	Bottom Stop Supply Point Capacity

## 10 Appendix 2 – Options for consideration

The Workgroup discussed the following options:

1. Minimum SOQ (no lower than that derived by Class 3 &4)
2. Ratchets without penalties (speed of correction)
3. Ratchets with sliding penalties (only applies to larger customers)

Options	Benefits	Drawbacks
1. Apply a minimum SOQ as derived in Class 3&4	<ol style="list-style-type: none"> <li>1. Approach is consistent with methodology used elsewhere</li> <li>2. Simple</li> <li>3. Concept of minimum SOQ has existed before</li> </ol>	<ol style="list-style-type: none"> <li>1. System changes may be needed to facilitate</li> </ol>
2. Apply Ratchets without penalties	<ol style="list-style-type: none"> <li>1. As MPRN's are daily read the correction would occur dynamically (little lag)</li> <li>2. Simple</li> </ol>	<ol style="list-style-type: none"> <li>1. No penalties</li> </ol>
3. Apply Ratchets with sliding penalties	<ol style="list-style-type: none"> <li>1. Targets penalties</li> </ol>	<ol style="list-style-type: none"> <li>1. Proportionally risk is same for all customers</li> <li>2. Will need to determine ranges for penalties</li> </ol>

A concern remains that the Ratchet Charges regime protects against “optimisation” i.e. under booking of the SOQ. However it is worth noting that Ratchets do not apply in the summer and thus if the purpose of the Ratchet Charge was to protect against optimisation then we might expect to see wholesale under booking of SOQ during the summer as these customers are not seasonal users albeit there base loads may be impacted by ambient temperatures to a certain extent.

The fact that the Ratchet regime only operates in the winter clearly identifies its purpose as managing over utilisation of capacity when the system is more likely to be constrained and not addressing the risk of optimisation.

It is also worth noting that only sites whose AQ is greater than 2m therms per annum are mandated to be daily read (Class 1) and thus must fall within the scope of the Ratchet Charges regime. All other sites can be non-daily metered (Class 3 & 4) were Ratchets Charges do not apply.

If parties did “optimise” the SOQ in Class 2 then the daily read requirement for such sites would mean any “benefit” would be effectively for 1 day as the SOQ will always ratchet up to the latest actual SOQ. Any error arising out of the under booking of the SOQ would create issues in terms of balancing and imbalance risk and charges and ultimately the any disconnect would of course be corrected at reconciliation.