

Stage 04: Final Modification Report

0418 and 0418A: Review of LDZ Customer Charges

At what stage is this document in the process?



The modifications propose changing LDZ Customer charges to base them on current Network costs



Panel recommended implementation of 0418



Panel did not recommend implementation of 0418A



High Impact: -



Medium Impact: Distribution Networks, Users



Low Impact: -

0418 0418A

Modification Report

20 December 2013

Version 4.0

Page 1 of 24

© 2013 all rights reserved

Contents

1	Summary	3
2	Why Change?	4
3	Solution	6
4	Relevant Objectives	10
5	Impacts and Costs	13
6	Implementation	16
7	Legal Text	16
8	Consultation Responses	17
9	Panel Discussions	23
10	Recommendation	24
11	Appendix	24

About this document:

This Final Modification Report will be presented to the Panel on 19 December 2013.

The Authority will consider the Panel's recommendation and decide whether or not this change should be made.



Any questions?

Contact:
Code Administrator



enquiries@gasgovernance.co.uk



0121 288 2107

Proposer:
0418 Scotia Gas Networks



joel.martin@sgn.co.uk



07966317785

Proposer:
0418A British Gas



andy.manning2@centrica.com



07789 575553

Xoserve:



commercial.enquiries@xoserve.com

1 Summary

Is this a Self-Governance Modification?

The Modification Panel determined that these are not self-governance modifications.

Why Change?

The DNs have been carrying out a programme of work to make LDZ transportation charges more cost reflective by basing them on DN specific costs rather than the national costs on which charges were based at the time of network sales. DNPC05 reviewed the split of DN costs between System costs and Customer costs and put the split on a DN specific basis. DNPC08 reviewed the structure of LDZ System charges and put them on a DN specific basis. The DNs have now reviewed the structure of the LDZ Customer charges and so they can be put on a DN specific basis.

Solution

Both modifications are proposing that Customer charges be put on a DN specific basis and also that the structure of the charges be altered to reflect the costs incurred.

Impacts and Costs

A restructuring of the customer charges will have distributional impacts, with some supply points facing increased transportation charges and others reductions.

Xoserve system costs are anticipated but it is not envisaged that there would be any increased administration costs for shippers. The intention is for systems development to be incorporated within the Nexus changes.

Implementation

No implementation timescale is proposed. As the charge change date specified in DN Licences is 01 April, the DNs suggested that the target implementation date should be 01 April 2015.

The Case for Change

The case for change is to improve the cost reflectivity of the LDZ Customer charges and to put all the LDZ transportation charges on a DN specific basis.

2 Why Change?

The DNs have been carrying out a programme of work to make the structure of LDZ transportation charges more cost reflective by basing them on DN specific rather than national costs. DNPC05 reviewed the split between System and Customer costs and put the split on a DN specific basis. DNPC08 reviewed the structure of LDZ System charges and put them on a DN specific basis. The DNs have now reviewed the structure of the LDZ customer costs with a view to setting customer charges on a DN specific basis.

Currently, apart from the relatively small fixed charges in the charging band 73.2-732MWh, all customer charges are based on supply point capacity (SOQ). The DNs have examined whether, given the costs that are reflected in customer charges, an alternative charging structure might be more cost-reflective. The costs reflected in customer charges are:

Supply Point Emergency Service Costs: These costs are mainly the costs of the emergency teams which are called out when a leak is reported downstream of the main. The costs of call-outs relating to mains are not included as these are treated as LDZ system costs. The costs include an allocation of call centre costs and overheads. From the DNs' investigations there is no evidence to show that these costs vary with the size of the supply point SOQ.

Services Replacement Costs (Repex): These costs are the costs of the replacement of services funded by the transporter or adopted by them. The cost evidence available provides a breakdown into costs for domestic and non-domestic supply points, but is not sufficiently detailed to provide evidence that costs vary by supply point size within the categories of domestic and non-domestic.

Leakage is a relatively small element of the costs associated with services that is too small to be treated as a separate cost category. It is included with Replacement because, for the purposes of cost recovery, this is considered the most appropriate cost category.

Asset Related Costs: Services Depreciation: The depreciation costs reflected in the customer charge are almost entirely depreciation of the capital cost of services funded by the transporter. The Domestic Load Connection Allowance (DLCA) is a statutory allowance set out in the Gas Act (1985), as a result of which the transporter does not charge for the first 10 metres of service laid in public property to domestic properties situated within 23 metres of an existing main. Since the separation of the British Gas Corporation into Transportation and Trading in 1994, all non-domestic connections and other domestic connections have been funded by the connectee. Therefore the great majority of the depreciation on services which is reflected in the customer charge can be attributed to the DLCA. There may be some depreciation relating to non-domestic services dating back to before 1994 when many British Gas Regions gave Load Connection Allowances to non-domestic connections, but the proportion this represents of the total is now very low.

Asset Related Costs: Network Rates: The Network Rates reflected in the customer charge are based on the same capital cost of services funded by the transporter as the depreciation and are treated in the same way.

The table below shows the relative importance of the costs which are reflected in the customer charges for each Network.

	Scotland	Southern	Wales & West	Northern
Emergency:				
Direct Costs	18.1%	17.3%	16.5%	14.1%
Opex+Work Management	3.6%	2.8%	5.0%	2.9%
Total Emergency	21.7%	20.0%	21.5%	17.0%
Replacement:				
Direct Costs	27.6%	32.4%	26.6%	22.1%
Opex+Work Management	5.4%	5.2%	8.1%	4.5%
Service Leakage	2.0%	2.1%	2.8%	2.6%
Total Replacement	35.0%	39.6%	37.5%	29.1%
Asset Related Costs:				
Regulated Depreciation	29.8%	25.1%	26.8%	32.7%
Network Rates	13.5%	15.3%	14.1%	21.2%
Total Asset Related Costs	43.3%	40.4%	41.0%	53.9%
Total	100.0%	100.0%	100.0%	100%

	East of England	London	North West	West Midlands
Emergency:				
Direct Costs	15.9%	20.1%	19.6%	16.8%
Opex+Work Management	3.4%	6.0%	4.7%	3.7%
Total Emergency	19.3%	26.1%	24.4%	20.5%
Replacement:				
Direct Costs	21.1%	19.6%	26.1%	26.6%
Opex+Work Management	4.6%	5.8%	6.3%	5.9%
Service Leakage	2.1%	1.8%	2.2%	2.1%
Total Replacement	27.8%	27.2%	34.5%	34.6%
Asset Related Costs:				
Regulated Depreciation	30.1%	28.6%	25.7%	27.9%
Network Rates	22.8%	18.1%	15.5%	17.0%
Total Asset Related Costs	52.9%	46.7%	41.1%	44.9%
Total	100.0%	100.0%	100.0%	100.0%

Revenue Recovery: The actual level of charges will be adjusted to ensure that the revenue recovered is in line with the System/Customer Charge split established in DNPC05.

0418

Currently, apart from the relatively small fixed charges in the charging band 73.2-732MWh all customer charges are based on supply point capacity (SOQ). There are three charging bands:-

1. 0 - 73.2 MWh: For supply points with an AQ below 73.2MWh there is a fixed unit rate in terms of pence per peak day kWh per day.
2. 73.2 - 732 MWh: For supply points with an AQ between 73.2 and 732 MWh there is also a fixed, but lower, pence per peak day kWh per day unit rate, plus the fixed charge depending on frequency of meter reads.
3. >732 MWh For supply points with an AQ greater than 732 MWh the unit rate depends on the SOQ of the supply point as it is calculated using an exponential function.

This Mod is proposing a more cost reflective charging structure based on the costs reflected in the Customer Charges. The charge would consist of three parts, reflecting the three main types of costs which are recovered through the customer charges. With the first two elements, Emergency costs and Services Replacement costs, the charges are set to be as cost reflective as possible given the evidence available. For the third element, Depreciation (mainly DLCA) costs, two options were initially proposed for consideration by the Workgroup. After consideration by the DNs Option 2 was discounted (charging based on the square root of the SOQ) as no substantial evidence could be found to justify charging on this basis. Therefore Option 1 has now been chosen as the method for charging of the Depreciation Costs.

The proposed charges will also be more cost reflective than the existing charges because they will be based on individual DN costs rather than national costs and will reflect an up-to-date balance of costs involved.

Emergency Costs: Because there is no evidence that supply point Emergency costs vary with supply point size it is proposed that these costs be recovered by a single flat rate charge which would apply to all supply points, irrespective of size.

Services Replacement Costs (Repex) In most Networks there is cost evidence that Services Replacement costs are higher for non-domestic supply points than for domestic supply points, which is to be expected on the basis that non-domestic supply points will, on average, have larger services. However the available cost data is not sufficiently detailed to provide evidence that costs vary by supply point size within the categories of domestic and non-domestic. Therefore for these Networks it is proposed that there should be one flat rate for the 0-73.2 MWh charging band, which consists mainly of domestic supply points, and a slightly higher flat rate for the 73.2 – 732 MWh and >732 MWh charging bands which consist mainly of non-domestic supply points. In Southern Network the cost evidence does not justify a higher rate for the 73.2 – 732 MWh and >732 MWh charging bands and therefore a single flat rate charge across all three charging bands is proposed.

Asset Related (DLCA) Costs: As discussed in Section 2, the great majority of the asset related costs on services which are reflected in the customer charge can be attributed to the DLCA. The proposers of the Mod consider that it was the intention of the Gas Act (1985) that the cost of the DLCA should be recovered from all gas customers and not just from those who benefitted from the Allowance.

This part of the charge is not intended to be cost reflective because it is to recover an allowance and not an operational cost.

After consideration by the DNs this Modification has been amended to reflect the following option for charging of the asset related costs based on a single flat rate charge applied to all Supply Points irrespective of size. This would mean that the

Depreciation costs would be recovered from all supply points, but with no attempt to vary the contribution by size of supply point. The option to base the single rate unit charge on the square root of the Supply Point's SOQ was considered, however no evidence to substantiate this option could be derived by the DNS jointly and was therefore discounted.

Impacts on Charges

There would be a flat rate charge for all three elements of the charge. For Emergency and asset related costs there would be a single flat rate charge across all supply points, and for Replacement for seven of the eight Networks there would be one flat rate for the 0-73.2 MWh charging band and a higher flat rate for the other two charging bands. For Southern Network there would be the same flat rate charge across all load bands.

For the purposes of illustration only how this charge might look in the Charging Statements for Scotland, based on 2011/12 revenue recovery, is shown in the table below.

Scotland	
AQ	Pence per Supply Point per day
Up to 73,200 kWh pa	12.0729
73,200 to 732,000 kWh pa	13.3941
732,000 kWh pa and above	13.3941

The impact of this structure on charges is shown in the table below.

	Scotland		Southern		Wales & West		Northern	
	Impact on:		Impact on:		Impact on:		Impact on:	
Load Band	Customer Charge	Total Charges	Customer Charge	Total Charges	Customer Charge	Total Charges	Customer Charge	Total Charges
0 - 73.2	3.6%	1.5%	4.2%	1.4%	2.8%	1.0%	4.4%	1.6%
73.2 - 146.5	(45.0%)	(10.5%)	(63.3%)	(12.1%)	(9.4%)	(1.8%)	(56.5%)	(10.6%)
146.5 - 293.1	(48.8%)	(6.6%)	(66.3%)	(7.4%)	(17.7%)	(2.1%)	(60.3%)	(6.7%)
293.1 - 439.6	(53.7%)	(4.7%)	(69.9%)	(5.2%)	(26.3%)	(2.2%)	(63.9%)	(5.1%)
439.6 - 586.1	(57.1%)	(4.0%)	(72.5%)	(4.4%)	(32.7%)	(2.2%)	(66.6%)	(4.4%)
586.1 - 732.7	(60.8%)	(3.5%)	(74.7%)	(3.9%)	(38.6%)	(2.2%)	(69.4%)	(3.9%)
732.7 - 2,198	(78.4%)	(5.1%)	(87.6%)	(5.7%)	(68.7%)	(5.0%)	(85.2%)	(5.8%)
2,198 - 2,931	(87.8%)	(5.6%)	(94.1%)	(6.0%)	(81.0%)	(6.0%)	(90.9%)	(6.1%)
2,931 - 5,861	(91.5%)	(5.7%)	(94.7%)	(6.0%)	(87.3%)	(6.6%)	(93.8%)	(6.2%)
5,861 - 14,654	(95.2%)	(5.9%)	(97.3%)	(6.1%)	(92.7%)	(7.2%)	(96.6%)	(6.3%)
14,654 - 29,307	(97.4%)	(5.9%)	(98.6%)	(6.0%)	(95.8%)	(7.7%)	(98.1%)	(6.2%)
29,307 - 58,614	(98.7%)	(5.8%)	(99.0%)	(5.9%)	(97.7%)	(8.0%)	(98.9%)	(6.2%)
58,614 - 293,071	(99.3%)	(5.7%)	(99.6%)	(5.8%)	(98.7%)	(8.3%)	(99.4%)	(6.1%)
>293,071			(99.9%)	(5.5%)	(99.7%)	(9.0%)		

	East of England		London		North West		West Midlands	
	Impact on:		Impact on:		Impact on:		Impact on:	
Load Band	Customer Charge	Total Charges	Customer Charge	Total Charges	Customer Charge	Total Charges	Customer Charge	Total Charges
0 - 73.2	5.5%	1.9%	5.0%	1.9%	3.8%	1.2%	3.5%	1.1%
73.2 - 146.5	(58.9%)	(12.4%)	(61.7%)	(14.6%)	(54.3%)	(9.0%)	(40.4%)	(6.6%)
146.5 - 293.1	(62.3%)	(7.7%)	(64.6%)	(9.1%)	(57.7%)	(5.8%)	(45.6%)	(4.3%)
293.1 - 439.6	(66.0%)	(5.6%)	(68.2%)	(6.5%)	(61.9%)	(4.2%)	(52.1%)	(3.2%)
439.6 - 586.1	(68.8%)	(4.7%)	(70.5%)	(5.5%)	(64.7%)	(3.6%)	(56.2%)	(2.8%)
586.1 - 732.7	(71.3%)	(4.2%)	(72.6%)	(4.9%)	(67.8%)	(3.1%)	(59.9%)	(2.6%)
732.7 - 2,198	(86.0%)	(6.4%)	(86.3%)	(6.9%)	(84.0%)	(5.4%)	(81.6%)	(4.9%)
2,198 - 2,931	(91.2%)	(6.8%)	(91.8%)	(7.4%)	(90.7%)	(6.0%)	(88.3%)	(5.5%)
2,931 - 5,861	(93.9%)	(7.0%)	(94.2%)	(7.6%)	(93.2%)	(6.2%)	(91.5%)	(5.8%)
5,861 - 14,654	(96.6%)	(7.2%)	(96.9%)	(7.8%)	(95.9%)	(6.6%)	(94.8%)	(6.3%)
14,654 - 29,307	(98.0%)	(7.4%)	(98.2%)	(8.0%)	(97.9%)	(6.9%)	(97.1%)	(6.8%)
29,307 - 58,614	(98.9%)	(7.5%)	(99.1%)	(8.1%)	(98.8%)	(7.2%)	(98.3%)	(7.2%)
58,614 - 293,071	(99.5%)	(7.5%)	(99.7%)	(8.2%)	(99.5%)	(7.5%)	(99.1%)	(7.6%)
>293,071	(99.9%)	(7.7%)	(99.8%)	(8.2%)	(99.8%)	(7.8%)	(99.6%)	(8.2%)

In all Networks this would result in an increase in total charges for the 0-73.2MWh charging band, ranging from 1.0% in Wales & West to 1.9% in East of England and London. For the 73.2-732 MWh charging band there would be reductions across all of the eight Networks. For the largest charging band, >732 MWh, there would be significant reductions in all Networks, ranging, in terms of total charges, from a maximum of 5.7% in Scotland to a maximum of 9.0% in Wales & West.

0418A

For the avoidance of doubt, this alternative proposal only seeks to change the charging methodology for the asset related costs, to a flat unit rate (pence/kWh) rather than the single flat rate (pence/supply point/day).

Currently, apart from the relatively small fixed charges in the charging band 73.2-732MWh all customer charges are based on supply point capacity (SOQ). There are three charging bands:-

1. 0-73.2 MWh: For supply points with an AQ below 73.2MWh there is a fixed unit rate in terms of pence per peak day kWh per day.
2. 73.2 - 732 MWh: For supply points with an AQ between 73.2 and 732 MWh there is also a fixed, but lower, pence per peak day kWh per day unit rate, plus the fixed charge depending on frequency of meter reads.
3. >732 MWh For supply points with an AQ greater than 732 MWh the unit rate depends on the SOQ of the supply point as it is calculated using an exponential function.

This Mod is proposing a more cost reflective charging structure based on the costs reflected in the Customer Charges. The charge would consist of three parts, reflecting the three main types of costs which are recovered through the customer charges. With the first two elements, Emergency costs and Services Replacement costs, the charges are set to be as cost reflective as possible given the evidence available. For the third element, Depreciation (mainly DLCA) costs, two options were initially proposed for consideration by the Workgroup. After consideration by the DNs Option 2 was discounted (charging based on the square root of the SOQ) as no substantial evidence could be found to justify charging on this basis. The Mod 418 workgroup therefore decided by majority Option 1 would be used as the method for charging of the Depreciation Costs, however, this alternative modification is proposing a third option in relation to the recovery of Depreciation costs. This Option 3 is a pence/kWh approach. Option 3 was raised at the working group at three separate meetings and the DNs agreed to look at the impact.

The proposed charges will also be more cost reflective than the existing charges because they will be based on individual DN costs rather than national costs and will reflect an up-to-date balance of costs involved.

Emergency Costs: Because there is no evidence that supply point Emergency costs vary with supply point size it is proposed that these costs be recovered by a single flat rate charge which would apply to all supply points, irrespective of size.

Services Replacement Costs (Repex) In most Networks there is cost evidence that Services Replacement costs are higher for non-domestic supply points than for domestic supply points, which is to be expected on the basis that non-domestic supply points will, on average, have larger services. However the available cost data is not sufficiently detailed to provide evidence that costs vary by supply point size within the categories of domestic and non-domestic. Therefore for these Networks it is proposed that there should be one flat rate for the 0-73.2 MWh charging band, which consists mainly of domestic supply points, and a slightly higher flat rate for the 73.2 – 732 MWh and >732 MWh charging bands which consist mainly of non-domestic supply points. In Southern Network the cost evidence does not justify a higher rate for the 73.2 – 732 MWh and >732 MWh charging bands and therefore a single flat rate charge across all three charging bands is proposed.

Asset Related (DLCA) Costs: As discussed in Section 2, the great majority of the asset related costs on services which are reflected in the customer charge can be attributed to the DLCA. The proposers of the Mod consider that it was the intention of the Gas Act (1985) that the cost of the DLCA should be recovered from all gas customers and not just from those who benefitted from the Allowance. This part of the charge is not intended to be cost reflective because it is to recover an allowance and not an operational cost.

This Modification proposes the following option for charging of the asset related costs based on a flat unit rate charge (pence/kWh) applied to all Supply Points irrespective of size. This would mean that the Depreciation costs would be recovered from all supply points, but with no attempt to vary the charge by size of supply point.

Impacts on Charges

There would be a flat rate charge for Emergency costs and Replacement costs. For Emergency costs there would be a single flat rate charge (pence/supply point/day) across all supply points, and for Replacement for seven of the eight Networks there would be one flat rate (pence/supply point/day) for the 0-73.2 MWh charging band and a higher flat rate (pence/supply point/day) for the other two charging bands. For Southern Network there would be the same flat rate charge across all load bands (pence/supply point/day).

For Asset Related costs there would be a flat unit rate (pence/kWh) applied to all supply points.

(See Appendix 1 for an impact assessment provided by the Transporters.)

4 Relevant Objectives

Impact of the modification on the Relevant Charging Methodology Objectives :	
Relevant Objective	Identified impact
a) save in so far as paragraphs (aa) or (d) apply, that compliance with the charging methodology results in charges which reflect the costs incurred by the licensee in its transportation business;	Positive
aa) that, in so far as prices in respect of transportation arrangements are established by auction, either: <ul style="list-style-type: none"> (i) no reserve price is applied, or (ii) that reserve price is set at a level - <ul style="list-style-type: none"> (I) best calculated to promote efficiency and avoid undue preference in the supply of transportation services; and (II) best calculated to promote competition between gas suppliers and between gas shippers; 	None
b) that, so far as is consistent with sub-paragraph (a), the charging methodology properly takes account of developments in the transportation business;	Positive
c) that, so far as is consistent with sub-paragraphs (a) and (b), compliance with the charging methodology facilitates effective competition between gas shippers and between gas suppliers; and	Positive
d) that the charging methodology reflects any alternative arrangements put in place in accordance with a determination made by the Secretary of State under paragraph 2A(a) of Standard Special Condition A27 (Disposal of Assets).	None
e) 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

Objective a)

The Workgroup considers that either Modification would better facilitate the achievement of Objective a). Changing the structure of customer charges in each DN to reflect the costs of that DN rather than reflecting a national cost structure facilitates the objective of the charging methodology resulting in charges which reflect the costs incurred by the licensee in its transportation business.

The DNs believe that the option put forward in Modification 0418 would also better facilitate this relevant objective since their analysis of costs and their drivers has produced the proposed charging functions, with those functions being driven by the data. The analysis sought to deliver cost reflectivity and the functions have been put forward to reflect their understanding of the costs they incur. While some Workgroup attendees do not believe that it has been demonstrated that the proposed functions would better reflect costs than the existing functions, the DNs do not consider there is any evidence to suggest the existing functions are appropriate. When establishing cost functions for the first time, based on data for each DN, the aim was to identify a cost reflective approach and the existing functions do not form a reasonable base case.

British Gas put forward Modification 0418A to specifically address the way in which DLCA costs are reflected. The DNs acknowledged that, being a statutory allowance, there was no clear cost driver that could be used to derive a suitable charging function that reflects this cost element. Modification 0418A put forward an alternative basis that is as cost reflective as that proposed by the DNs.

British Gas considers the modification report lacks the required supporting evidence for the proposed changes in respect of the allocation of Emergency Costs and Service Replacement Costs, which has hindered their ability to properly judge both modifications against relevant objective (a).

In respect of Modification 0418A, E.ON UK disagrees with the assertion that the cost recovery “*would result in cost recovery from 98% of the group of customers the allowance was intended for*” as they cannot see that the intent of the DLCA was to protect all domestic customers from the cost recovery - it was intended to assist only those domestic customers who didn't have access to the gas network at that time or in the future.

Responding to the further consultation, ScottishPower and EDF Energy do not believe that either modification positively impacts this relevant objective. EDF Energy noted that both modifications state that the structure of LDZ customer charges for each DN will be more reflective of the costs that each DN incurs instead of reflecting national cost structure and therefore meets Relevant Objectives a) and b). However, neither modification has provided clear evidence that introducing either proposed alternative charging structure will be more cost-reflective. Whilst the proposed charging structures has uncovered an extra level of granularity which may provide additional clarity on DN costs, EDF Energy does not agree with the rationale that restructuring the share each type of customers pays is cost reflective. The reapportionment of the share customers pay as proposed in both modifications will not better facilitate Relevant Objective (a) as the Licensees need to recover these costs irrespective of which customer type incurs the costs. These costs cannot be attributed to a particular type of customer and therefore the proposed alternative charging structure cannot be considered to be more cost-reflective.

Objective b)

The Workgroup considers that either Modification would better facilitate the achievement of Objective b), that the charging methodology properly takes account of developments in the transportation business, because it would make the structure of LDZ customer charges reflect the structure of the distribution networks, and so reflect network sales.

Responding to the further consultation, ScottishPower and EDF Energy do not believe that either modification positively impacts this relevant objective. EDF Energy commented that the provision of a structure of LDZ customer charges for each DN instead of reflecting national cost structure may be considered to better facilitate Relevant Objective (b) as it attempts to reflect the composition of the DNs following the network sales that took place 8 1/2 years ago. However, as noted under Relevant Objective (a) it was not clear that this derives any benefit.

Objective C)

Some Workgroup attendees considered that, if the intent of the Gas Act was to recover the DLCA allowance from all gas customers, then a p/kWh charge, as proposed in Modification 0418A, would provide a reasonably balanced apportionment of this cost across all customers. On the other hand, a p/supply point charge as proposed in Modification 0418 would recover approximately 98%* of the cost from the group of customers the allowance was intended for, which seems inappropriate. By recovering the asset related costs on a pence/kWh basis, rather on a pence/supply point basis, it better preserves the intent of the DLCA and therefore avoids distorting the market. Avoiding market distortions facilitates effective competition between Shippers.

**Source: Xoserve, August 2012.*

Other Workgroup attendees considered that Modification 0418 provides a reasonably balanced apportionment of costs in line with the DLCA by allocating costs to all customers in a non-discriminatory manner. They saw pence per supply point as an appropriate basis when recovering a supply point related cost allowance, with costs not related to throughput of gas.

Where there is a level of cost to be recovered from all customers with no clear underlying cost driver, as is the case for the DLCA, the current practice in some parts of the energy industry is to apply a p/kWh charge. Examples of this approach are the NTS SO Commodity charge, the TO Exit Commodity charge and Assistance for Areas with High Electricity Distribution Costs allowance (AAHEDC). On the other hand, there are no examples of a pence/customer approach to recover a level of cost that is to be socialised.

Some Workgroup attendees consider that Modification 0418A maintains current industry practice and hence is familiar to the industry and an approach that is understood. Adopting a novel approach rather than which is familiar and established would introduce uncertainty into the market and increase the risks faced by Shippers. Implementing Modification 0418A in preference to 0418 would avoid this detriment and so facilitate the securing of effective competition between Shippers.

While there are no examples of a pence per customer approach to recover costs, the Transporters emphasised that some costs, such as overhead costs, are allocated relative to direct costs and so form an uplift. By allocating DLCA costs on a per supply point basis, Modification 0418 is effectively maintaining this standard process. This is also, therefore, not a novel approach and so does not introduce inappropriate uncertainty nor risk into the market.

Some Workgroup attendees felt that the larger percentage impacts of Modification 0418A on some market sectors would mean that its implementation would be more disruptive than that of Modification 0418. Minimising disruption in charge levels would be consistent with maintaining stable and predictable transportation charges and hence be consistent with facilitating the securing of effective competition.

The Workgroup also acknowledged that either Modification would affect only the Customer Charges themselves and have no impact on compliance with paragraphs 2, 2A and 3 of Standard Special Condition A4 of the Transporter's Licence.

Corona Energy and Total were concerned that, as the proposals for UNC Modification 0418A results in charges increasing for larger customers who are already contributing too much, then the net effect of the modification is that it reduces the cost reflectivity of the charging methodology and so it is detrimental to the relevant objectives.

National Grid Distribution considers Modification 0418A has a negative impact on facilitating objective C), due to the different means of reflecting the asset-related, largely DLCA, costs in the two modifications and the very different impacts that these create.

RWE npower considers the proposed new charging structure around LDZ customer charges as per Modification 0418A will help to simplify the customer pricing process compared to the current SOQ based structure and hence will facilitate competition.

Scotia Gas Networks considers Modification 0418A does not better facilitate this objective. The rationale for this position is related to the treatment of the DLCA costs within Modification 0418A, which would attribute the DLCA costs on a commodity charge rate basis which would impact significantly on a specific segment of the market. The impact on a specific sub-set of gas Shippers, those concerned with industrial and Commercial gas supply would be negative, and therefore would not support this relevant objective.

Responding to the further consultation, ScottishPower and EDF Energy do not believe that either modification positively impacts this relevant objective. EDF Energy commented that there is no clarity on the detailed composition of the Asset Related Costs - Services Depreciation. It is composed of the statutory Domestic Load Connection Allowance (DLCA) as set out in the Gas Act (1985) and potentially some depreciation relating to non-domestic services dating back to before 1994 when many British Gas Regions gave Load Connection Allowances to non-domestic connections. However, it is not clear that to amend the charging structure for the recovery of these costs will better facilitate effective competition between gas shippers and between gas suppliers.

5 Impacts and Costs

Consideration of Wider Industry Impacts

The system changes should be accommodated as part of Project Nexus.

Costs

Indicative industry costs – User Pays	
Classification of the modification as User Pays or not and justification for classification	
These are not User Pays Modifications since no User Pays service is to be created nor amended. Any system costs to implement the change will be met by the Transporters.	
Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification	
NA	
Proposed charge(s) for application of Users Pays charges to Shippers	
NA	
Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from Xoserve	
NA	

Impacts

Impact on Transporters' Systems and Process	
Transporters' System/Process	Potential impact

UK Link	• None
Operational Processes	• None
User Pays implications	• None

Impact on Users	
Area of Users' business	Potential impact
Administrative and operational	• None
Development, capital and operating costs	• None
Contractual risks	• None
Legislative, regulatory and contractual obligations and relationships	• None

Responding to the further consultation, EDF Energy noted that it would incur costs to modify internal systems in order to accommodate the implementation of either modification, with estimated costs to its settlements systems alone in the region of £10k. It would also be required to review its pricing strategy in order to ensure that the costs incurred are attributed to the corresponding customer type.

ScottishPower indicated it would have to review its customer tariffs.

Impact on Transporters	
Area of Transporters' business	Potential impact
System operation	• None
Development, capital and operating costs	• Implementation costs of up to £1m were anticipated by Xoserve to amend existing systems. The present intention is for implementation to coincide with the Nexus changes and no estimate of the change in Nexus costs is available.
Recovery of costs	• None
Price regulation	• None
Contractual risks	• None
Legislative, regulatory and contractual obligations and relationships	• None
Standards of service	• None

Impact on Code Administration	
Area of Code Administration	Potential impact
Modification Rules	<ul style="list-style-type: none"> • None
UNC Committees	<ul style="list-style-type: none"> • None
General administration	<ul style="list-style-type: none"> • None

Impact on Code	
Code section	Potential impact
TPDY	<ul style="list-style-type: none"> • Charging methodology to be modified

Impact on UNC Related Documents and Other Referenced Documents	
Related Document	Potential impact
Network Entry Agreement (TPD I1.3)	<ul style="list-style-type: none"> • None
Network Exit Agreement (Including Connected System Exit Points) (TPD J1.5.4)	<ul style="list-style-type: none"> • None
Storage Connection Agreement (TPD R1.3.1)	<ul style="list-style-type: none"> • None
UK Link Manual (TPD U1.4)	<ul style="list-style-type: none"> • None
Network Code Operations Reporting Manual (TPD V12)	<ul style="list-style-type: none"> • None
Network Code Validation Rules (TPD V12)	<ul style="list-style-type: none"> • None
ECQ Methodology (TPD V12)	<ul style="list-style-type: none"> • None
Measurement Error Notification Guidelines (TPD V12)	<ul style="list-style-type: none"> • None
Energy Balancing Credit Rules (TPD X2.1)	<ul style="list-style-type: none"> • None
Uniform Network Code Standards of Service (Various)	<ul style="list-style-type: none"> • None

Impact on Core Industry Documents and other documents	
Document	Potential impact
Safety Case or other document under Gas Safety (Management) Regulations	<ul style="list-style-type: none"> • None
Gas Transporter Licence	<ul style="list-style-type: none"> • None

Other Impacts	
Item impacted	Potential impact
Security of Supply	• None
Operation of the Total System	• None
Industry fragmentation	• None
Terminal operators, consumers, connected system operators, suppliers, producers and other non code parties	• None

6 Implementation

While no implementation timescale is proposed, as these modifications involve changes to the LDZ transportation charges and the charge change date specified in the DNs' Licences is 01 April, the DNs suggested that the target implementation date should be 01 April 2015. However, this should be considered on the context of the economic and efficient implementation of the Nexus changes such that an alternative implementation date may be appropriate. Shipper representatives argued that any change should be on 1 April rather than any other date, consistent with other changes to charges.

Noting the proposed implementation date, EDF Energy commented that delivering these changes in an increasingly congested systems development programme is challenging, particularly in light of the number of other system developments that are taking place across the industry (Project Nexus, Smart Metering mass roll out, GB gas day changes and Change of Supplier reform.)

7 Legal Text

Text

Due to the size of the files, the legal text for each modification, prepared by Scotia Gas Networks, has been published as separate documents alongside this report.

8 Consultation Responses

Representations were received from the following parties:

Company/Organisation Name	Support Implementation or not?		Stated Preference
	0418	0418A	
British Gas	Not in Support	Comments	0418A
Corona Energy	Supports	Not in Support	0418
E.ON UK	Supports	Not in Support	0418
Gazprom	Supports	Not in Support	0418
National Grid Distribution	Supports	Not in Support	0418
Northern Gas Networks	Supports	Not in Support	0418
RWE npower	Not in Support	Supports	0418A
Scotia Gas Networks	Supports	Not in Support	0418
SSE	Supports	Supports	0418A
Total	Supports	Not in Support	0418
Wales & West Utilities	Supports	Not in Support	0418
WINGAS	Supports	Not in Support	0418

0418

Of the 12 representations received 10 supported implementation and 2 were not in support.

0418A

Of the 12 representations received 2 supported implementation, 1 provided comments and 9 were not in support.

Preference

Of the 12 representations received, 9 stated a preference for Modification **0418** and 3 stated a preference for Modification **0418A**.

Summary Comments

British Gas is concerned that, though the intent of Modification 0418 is to change customer capacity charges to be more cost reflective. the whole allowed revenue is split between LDZ and customer charges and the LDZ charge percentages were made regionally specific in 2010 under DNPC05. The charging methodology was further adjusted between customer and LDZ charges under DNPC08 in 2011. Hence the remaining customer capacity charges are already regionally based and not on a national basis and so no case for change has been made.

Additionally, although the proposer has presented the conclusion that Emergency Costs and Service Replacement Costs do not vary with supply point, no evidence for this has been provided - either as part of this consultation or through the workgroup.

British Gas feels that the intention of the DCLA legislation was to recover the connection cost from all system users and not just domestic customers. There would seem little point in the DCLA legislation removing costs from domestic customers to then effectively reapply them through distribution charging, as would be the case with Modification 0418. Modification 0418 will recover over 98.5% of the cost from domestic customers (and British Gas note would therefore appear to be regressive in nature),

0418 0418A
Modification Report
20 December 2013

Version 4.0

Page 17 of 24

© 2013 all rights reserved

whereas Modification 0418A will recover 60.5% from domestic customers. For clarity, the current SOQ allocation recovers approximately 66% from domestic customers.

Corona Energy is concerned that Modification 0418A proposes that asset related costs merits different treatment to the rest of the allowed revenue recovered through this charge. As noted in the workgroup report, the majority of the asset related costs originate from the connection of new domestic Small Supply Points (that is properties with an AQ of <73.2MWh). Corona Energy fails to understand why the costs that this charging tier incurs should be cross-subsidised by other customers in other charging tiers as this goes against fundamental charging principles and will be detrimental to the concept of fair cost targeting.

E.ON UK considers the “per supply point approach” set out in Modification 0418 does reduce the risk of volatility of DLCA cost recovery by the networks, which in turn provides certainty for suppliers in tariff setting.

Gazprom considers it is worth noting that Ofgem have recently highlighted concerns over inappropriate cross subsidies in particular in its decision letter for Modification 0428 where it felt Multi Metered Supply Points were benefiting from a subsidised customer charge. The workgroup report identifies that Modification 0418 recovers approximately 98% of the cost from the group of customers the allowance was intended for, whilst avoiding cross subsidy and maintaining stable and predictable transportation charges

National Grid Distribution considers that Modification 0418 would result in charges which better reflect the transportation costs than the current Customer charge functions do. It would result in the DLCA costs which, being an allowance which therefore cannot be reflected in a cost- reflective manner, being reflected across all customers’ charges in a way that would not create significant negative impacts for any group of customers, so facilitating effective competition between gas shippers and gas suppliers. By contrast, Modification 0418A would result in the DLCA costs being reflected in a manner that would create extremely large negative charge impacts for many customers. This would be disruptive to effective competition without any clear justification for such a significant rebalancing of charges.

Northern Gas Networks considers implementation of Modification 0418 would make the charging methodology more cost reflective, which in turn would help facilitate effective competition between gas shippers and gas suppliers. By focusing on changing the charging methodology for asset related costs to a flat unit rate (pence/kWh) rather than the single flat rate (pence/supply point/day), they consider the implementation of Modification 0418A would create costs being reflected in a way that is not aligned to customers’ use of network assets.

RWE npower welcomes the fact that through either of these modifications, LDZ customer charges will be based on DN specific costs rather than national costs, which will better reflect DN costs. They support Modification 0418A as it is a fairer and more cost reflective way of distributing the said DN specific cost across all customer segments compared to Modification 0418 where vast majority of the costs recovery will be through domestic consumers. Even though the proposer of Modification 0418 has stated there is no correlation between Supply Point Emergency Service Costs/Service Replacement Costs and size of the supply point, no evidence has been provided so far to prove this is the case and to justify a pence per supply point charge and therefore evidence should be presented to the industry prior to making a decision.

Both Scotia Gas Networks and Wales & West Utilities consider both modifications would introduce changes to the charging methodology which would permit a DN specific charging basis for the customer charge as opposed to the national structure which has been in place since network sales.

SSE supports the move away from capacity based charges, which will bring the transportation charges into line with domestic and SME customer pricing. They also support the abolition of the complex calculation of capacity charges for large users.

Total considers Modification 0418 would make LDZ transportation charges more cost reflective by basing them on DN specific costs by reforming the structure of the charges to make them more appropriately reflect the costs incurred. They acknowledge

0418 0418A
Modification Report
20 December 2013

Version 4.0
Page 18 of 24

© 2013 all rights reserved

that some supply points will face increased transportation charges and others reductions but consider that Modification 0418 does this in a more equitable manner.

WINGAS considers that Modification 0418, if implemented would mean that the DLCA costs (which being an allowance cannot be reflected in a cost reflective manner) would result in it being reflected across all customers' charges in a way that would not create significant negative impacts for any group of customers. By contrast, 0418A would result in the DLCA costs being reflected in a manner that would create extremely large negative charge impacts for many customers by switching from a pence per supply point per day to a pence per kWh methodology. This would be disruptive to effective competition by imposing unreasonable charges on consumers who will not receive the benefits of the aforementioned allowance without any clear justification.

Additional Issues Identified in Responses

Gazprom feels it is important to highlight the potentially significant impact on customers arising from the different approach in Modification 0418A and in particular extremely large negative impacts for many sizes of customers, with some customers (those with very large loads) seeing increases of over 100% in their distribution transportation charges and most industrial customers seeing distribution charge increases of over 20%.

Gazprom notes the fact that the allowance, by supporting the growth of connections in the domestic market, delivers long term commercial benefits to domestic Shippers and Suppliers as it expands the market for their goods and services so it would seem appropriate that the majority of the costs are recovered from that group of customers.

SSE notes that from a Supplier's perspective the move away from capacity based charges is welcome as it brings the transport charges in line with domestic and SME customer pricing. They would like all the capacity charges to be abolished. Both modifications are consistent with the Retail Market Review requirement for simpler domestic tariffs.

Wales & West Utilities notes that whilst Modification 0418 would lead to a small increase to those customers in the domestic charging band, this would be offset to some extent following Ofgem's direction to implement Modification 0428 which will use the single meter point for charging purposes.

Panel Considerations

The Workgroup was requested to consider the following points by Panel:

- Consider the additional information/analysis that had subsequently been made available since the consultation period and whether this would exert any material effect on either of the modifications or previous responses made;
- Clarify and differentiate the User Pays elements to reflect the allocation made across different categories of Transporter User (iGTs, DNs, NTS).

Workgroup consideration of Additional Issues

The Workgroup considered the new or additional issues raised in consultation responses.

- The Workgroup has reviewed the additional information and analysis provided and considers it would exert a material effect on previous responses made

(see appendix 2 published along side this report). Some participants were concerned that the additional analysis was not sufficient to answer all their questions concerning a) the allocation of emergency costs between SSPs and LSPs; b) how transfer service costs break down between SSP and LSPs. Transporters advised that further additional information was not available to the level requested. Therefore, the Workgroup invites the Panel to agree that these modifications should be submitted for further consultation to allow parties the opportunity to reconsider their representations.

- These modifications are not User Pays as it is proposed that implementation coincides with Project Nexus implementation and therefore the costs associated with these modifications is part of the overall Project Nexus funding arrangements between Transporters.

Further Consultation

At the November Panel meeting Panel Members accepted the recommendation in the Workgroup Report that further consultation be undertaken in light of the additional cost information that had been added to the FMR. Both modifications were subsequently issued to consultation in order to give an opportunity for parties to consider if whether they wish to amend their representations, or submit a first representation, in light of the additional cost information.

Representations were received from the following parties:				
Company/Organisation Name	Support Implementation or not?		Stated Preference	
	0418	0418A		
British Gas	Not in Support	Comments	0418A	Further concerns noted
Corona Energy	Supports	Not in Support	0418	No change in view
DONG Energy	Supports	Not in Support	0418	
EDF Energy	Not in Support	Not in Support	Neither	
National Grid Distribution	Supports	Not in Support	0418	No change in view
RWE npower	Not in Support	Supports	0418A	No change in view
Scotia Gas Networks	Support	Not in Support	0418	No change in view
ScottishPower	Not in Support	Not in Support	0418A	

The further consultation elicited responses from 3 parties who had not previously submitted a representation to the primary consultation, and further responses from 5 parties who had reconsidered their positions in light of the additional information provided.

0418

Of the 8 representations received, 4 supported implementation and 4 were not in support.

0418A

Of the 8 representations received 1 supported implementation, 1 provided comments and 6 were not in support.

0418 0418A
Modification Report

20 December 2013

Version 4.0

Page 20 of 24

© 2013 all rights reserved

Preference

Of the 8 representations received, 4 stated a preference for Modification **0418** and 3 stated a preference for Modification **0418A**; one party did not express a preference as support was not offered for either modification.

Summary Comments

The further consultation sought views on two specific questions.

Q1: Has the provision of additional information changed your previous views made in representations? If so, please explain why.

Of the 5 parties who had previously submitted a representation to the primary consultation, 4 remained unchanged in their views. However one party, British Gas, stated its initial concerns had been amplified rather than allayed following its assessment of the additional information, which had failed to meet the expectation that it would provide more detail and clarity. In the absence of clear supporting evidence British Gas was unsure that the modification should proceed any further. At a time of increasing focus on the cost of residential bills, it did not believe it was acceptable to put extra costs on customers without clear evidence and that changing the customer capacity methodology as proposed by Modification 0418 is not shown to be an improvement in cost reflectivity.

Q2: Are there any new or additional issues that you believe should be recorded in the Modification Report due to the provision of additional information?

British Gas commented that the Modification Report needed to make clear the nature of the additional information provided. Assuming that it is interpreting the information provided correctly, British Gas believed it is not evidence clarifying/supporting the cost reflectivity of the modification and only gives the GDNs' point of view regarding allocation of these costs (which is already provided in the modification itself). This does not assist the user to make adequate decisions about the real drivers behind these costs and British Gas was concerned that the information was capable of being misinterpreted if not explained fully.

New Representations

Representations were received from 3 parties who had not previously submitted a response to the primary consultation.

Whilst fully supporting the principle of cost reflective charging, ScottishPower stated it was unable to support the implementation of either of these modifications, as sufficient evidence had not been presented which determines conclusively what proportion of the customer charges should be directly attributable to a particular customer group. In its view such a change requires to be fully justified, and until sufficient evidence is presented to demonstrate change is required, ScottishPower believed that costs should be socialised and recovered against all customers based on the SOQ at a p/kWh rate.

EDF Energy also fully supported the principle of cost reflective charging. However, it noted that in this case the network costs being considered (Emergency costs and Services Replacement costs) appeared to be generally overhead type costs without a strong or direct driver to a particular customer or particular type/class of customer. Allocating such costs was therefore likely to be arbitrary and should be done in a manner that least distorts cost reflectivity. Adding further charges to a customer bill that they cannot influence will impact affordability as vulnerable customers will pay proportionately more with a flat rate charge in comparison to those in the higher income deciles (on average).

EDF Energy echoed British Gas' concerns that these modifications come at a time when energy affordability is attracting increasing focus and has become a key political topic.

0418 0418A
Modification Report

20 December 2013

Version 4.0

Page 21 of 24

© 2013 all rights reserved

Summary of Representations received for both Consultations

Representations were received from the following parties:			
Company/Organisation Name	Support Implementation or not?		Stated Preference
	0418	0418A	
British Gas	Not in Support	Comments	0418A
Corona Energy	Supports	Not in Support	0418
DONG Energy	Supports	Not in Support	0418
EDF Energy	Not in Support	Not in Support	Neither
E.ON UK	Supports	Not in Support	0418
Gazprom	Supports	Not in Support	0418
National Grid Distribution	Supports	Not in Support	0418
Northern Gas Networks	Supports	Not in Support	0418
RWE npower	Not in Support	Supports	0418A
Scotia Gas Networks	Supports	Not in Support	0418
ScottishPower	Not in Support	Not in Support	0418A
SSE	Supports	Supports	0418A
Total	Supports	Not in Support	0418
Wales & West Utilities	Supports	Not in Support	0418
WINGAS	Supports	Not in Support	0418

0418

Of the 15 representations received 11 supported implementation and 4 were not in support.

0418A

Of the 15 representations received 2 supported implementation, 1 provided comments and 12 were not in support.

Preference

Of the 15 representations received, 10 stated a preference for Modification **0418** and 4 stated a preference for Modification **0418A**.

The Panel Chair summarised that both modifications proposed that customer charges be put on a DN specific basis and also that the structure of the charges be altered to reflect the costs incurred.

The modifications differed in that Modification 0418 proposed charging for the asset related costs (mainly the Domestic Load Connection Allowance (DLCA) costs) based on a single flat rate charge applied to all Supply Points irrespective of size. This would mean that these costs would be recovered from all Supply Points, but with no attempt to vary the contribution by size of Supply Point. Whereas Modification 0418A proposed that asset related costs be based on a flat unit rate charge (pence/kWh) applied to all Supply Points, which would mean that the costs would be recovered from all Supply Points but the amount paid would vary with consumption.

Members recognised that implementation of either modification would better facilitate the achievement of relevant objective a) by changing the structure of customer charges in each DN to reflect the costs of that DN rather than reflecting a national cost structure, and facilitating the objective of the charging methodology resulting in charges which reflect the costs incurred by the licensee in its transportation business. In addition, some Members considered that Modification 0418 would further benefit relevant objective a) since the proposed charging functions are being driven by data.

Members recognised that implementation of either modification would better facilitate the achievement of relevant objective b), in that the charging methodologies proposed properly to take account of developments in the transportation business, because either would make the structure of LDZ customer charges reflect the structure of the distribution networks.

Some Members considered that Modification 0418 furthered relevant objective c) as it provides a reasonably balanced apportionment of costs in line with the DLCA by allocating costs to all customers in a non-discriminatory manner. They saw pence/supply point as an appropriate basis when recovering a Supply Point related cost allowance, with costs not related to throughput of gas. Some Members also felt that the larger percentage impacts of Modification 0418A on some market sectors would mean that its implementation would be more disruptive than that of Modification 0418. Therefore, Modification 0418 would be consistent with relevant objective c) by facilitating effective competition by minimising potential disruption in charge levels and be consistent with maintaining stable and predictable transportation charges.

Some Members considered that Modification 0418A would better facilitate relevant objective c) as the intent of the Gas Act is to recover the DLCA allowance from all gas customers. Given this, a pence/kWh charge would provide a reasonably balanced apportionment of this cost across all customers. Whereas a pence/supply point charge (as proposed in Modification 0418) would only recover approximately 98% of the cost from the group of customers the allowance was intended to benefit, which seems inappropriate. Therefore recovering the asset related costs on a pence/kWh basis, rather on a pence/supply point basis, better preserves the intent of the DLCA and avoids distorting the market. Avoiding market distortions facilitates the securing of effective competition.

Some Members recognised that Modification 0418A maintained current industry practice and hence is familiar to the industry and offers an approach that is understood. Adopting a new approach rather than retaining that which is familiar and established would introduce uncertainty into the market and increase the risks faced by Shippers. The implementation of Modification 0418A in preference to Modification 0418, would avoid this detrimental effect and so facilitate relevant objective c) by the securing of effective competition between Shippers.

Members then voted and with 9 votes cast in favour, determined to recommend that Modification 0418 should be implemented. With 1 vote cast in favour, Members failed to determine to recommend that Modification 0418A should be implemented.

Members then considered which of the two modifications, if one were to be implemented, would be expected to better facilitate the relevant objectives. With 9 votes preferring Modification 0418, and 1 vote preferring Modification 0418A, Members determined that, of the two, Modification 0418 would be expected to better facilitate the relevant objectives.

10 Recommendation

Panel Recommendation

Having considered this Modification Report, the Panel recommends:

- that proposed Modification 0418 better facilitates the Relevant Objectives than proposed Modification 0418A;
- that proposed Modification 0418 should be made; and
- that proposed Modification 0418A should not be made.

11 Appendix

The DNs have provided an impact assessment relating to Modification **0418A** in the spreadsheet published alongside this report (Appendix 1).

The DNs have provided additional analysis relating to these modifications in a spreadsheet published alongside this report (Appendix 2).