

UNC Final Modification Report

At what stage is this document in the process?

# UNC 0571 0571A:






## Application of Ratchets Charges to Class 1 Supply Points Only (and Class 2 Supply Points with an AQ above 73,200kWh)











- 01 Modification
- 02 Workgroup Report
- 03 Draft Modification Report
- 04 Final Modification Report

Recognising the introduction of 4 new classes of Supply Points under Project Nexus and the wider availability of daily read sites with lower AQs, these modifications aim to limit the application of Ratchets Charges to:

**0571 - Class 1 Supply Points only;**

**0571A – Class 1 Supply Points and Class 2 Supply Points with an AQ above 73,200kWh**

	UNC Modification Panel consideration is due on 16 February 2017
	
	High Impact: Shipper Users and Transporters
	Medium Impact: None
	Low Impact: None

Contents		 Any questions?
<b>1 Summary</b>	<b>3</b>	Contact: <b>Code Administrator</b>
<b>2 Why Change?</b>	<b>4</b>	 <a href="mailto:enquiries@gasgovernance.co.uk">enquiries@gasgovernance.co.uk</a>
<b>3 Solution</b>	<b>8</b>	
<b>4 Relevant Objectives</b>	<b>9</b>	
<b>5 Implementation</b>	<b>10</b>	 0121 288 2107
<b>6 Impacts</b>	<b>11</b>	
<b>7 Legal Text</b>	<b>11</b>	<b>Proposer 0571:</b> <b>Steve Mulinganie</b>
<b>8 Consultation Responses</b>	<b>13</b>	 <a href="mailto:stevemulinganie@gazprom-mt.com">stevemulinganie@gazprom-mt.com</a>
<b>9 Panel Discussions</b>	<b>28</b>	
<b>10 Recommendations</b>	<b>29</b>	
<b>11 Appendix 1 - Ratchet Charges</b>	<b>30</b>	 07590 245 256
<b>12 Appendix 2 - Options for consideration</b>	<b>31</b>	<b>Proposer 0571A:</b> <b>Colette Baldwin</b>
<b>13 Appendix 3 - Analysis of Sites eligible for Ratchets</b>	<b>32</b>	 <a href="mailto:colette.baldwin@eonenergy.com">colette.baldwin@eonenergy.com</a>
<b>About this document:</b>		 07793 648490
This Final Modification Report will be presented to the Panel on 16 February 2017. The Authority will consider the Panel's recommendations and decide whether or not which, if any, change should be made.		<b>Transporter:</b> <b>National Grid Distribution</b>
<b>Modification Timetable:</b>		 <a href="mailto:chris.warner@ngrid.com">chris.warner@ngrid.com</a>
Initial consideration by Workgroup	28 January 2016	
Amended Modification considered by Workgroup	24 November 2016	
Workgroup Report presented to Panel	15 December 2016	
Draft Modification Report issued for consultation	15 December 2016	
Consultation Close-out for representations	24 January 2017	 01926 653541
Final Modification Report published for Panel	25 January 2017	<b>Systems Provider:</b> <b>Xoserve</b>
UNC Modification Panel deferral decision	16 February 2017	 <a href="mailto:commercial.enquiries@xoserve.com">commercial.enquiries@xoserve.com</a>
UNC Modification Panel recommendations	18 May 2017	

# 1 Summary

## Are these Self-Governance Modifications?

These are not considered to be Self-Governance modifications, because they are expected to have a material impact on consumers, and the commercial activities connected with the shipping of gas.

The Workgroup agreed with the Modification Panel's view that these modifications were not suitable for Self-Governance as they would have a material impact on the contractual arrangements between Suppliers and Consumers by removing the need to cater for the recovery of ratchet charges from some or potential all Product Class 2 consumers. In addition, commercial incentives would be removed or reduced from the commercial arrangements between Transporters and Shippers.

## Are these Fast Track Self-Governance Modifications?

Fast Track procedures do not apply because these are not housekeeping modifications.

## Why Change?

Project Nexus is introducing new customer classes so a customer's capacity will no longer be the only determination of what allocation and settlement rules will apply to that customer. 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, 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.

Customers who are elected into Settlement Class 2 by their Shipper will have to operate within the requirements of their settlement class, which includes, amongst other things them setting their own capacity requirements with the networks, and being subject to any consequences for exceeding it or getting it wrong.

Under the current design for Settlement Class 2, there is a risk that if smaller customers with only a domestic-sized demand are elected into this class they may find themselves exposed to ratchet charges for exceeding their booked capacity because they are exposed to an unforeseen weather event that sees them temporarily increase their heating load.

It could be argued that Shippers can avoid this risk by electing the customer into Settlement Class 3 however this could be perceived as a barrier for Shippers operating mixed portfolio supply points in any of the 3 non-mandatory settlement classes.

## Solution

**0571** proposes that Ratchets Charges should only apply to Class 1 Supply Points.

**0571A** proposes that Ratchets Charges should only apply to Class 1 Supply Points and Class 2 Supply Points with an annual AQ that exceeds 73,200 kWhs.

## Relevant Objectives

Some participants consider these modifications would further relevant objectives a), d) and f).

## Implementation

No implementation timescales are proposed.

## Do these modifications impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

Although it would be beneficial if these modifications were implemented soon after the Project Nexus Implementation Date, the changes proposed would have no impact Project Nexus implementation.

## 2 Why Change?

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

It should be noted that the Project Nexus Settlement BRD describes the Classes of Supply Points as follows:

Class 1 - Daily Metered Time Critical Readings;

Class 2 - Daily Metered not Time Critical Readings;

Class 3 - Batched Daily Readings;

Class 4 - Periodic Readings.

### Modification 0571

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 minutes data.

As part of Project Nexus, the industry re-examined the current criteria, which requires an individual site to be daily metered. Though the general view expressed during these meetings was that the primary requirement for a site to be daily read was to maintain the integrity of settlement, it was agreed that the current threshold of 2m therms does ensure that the largest sites provided some indication of their peak daily offtake. Crucially the current threshold was deemed to be appropriate and that an individual sites peak daily offtake under that threshold would not need to be specifically set and could be derived via an estimation algorithm, except in the very rare circumstance where it occupied a critical point on the network. At that time, the industry agreed that these sites did not have to be daily read and that their individual peak SOQ is not material to the network, so there is no justification 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 there base loads may be impacted by ambient temperatures to a certain extent.

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 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 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. The Proposer believes 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. It is therefore proposed to limit Ratchet Charges to Class 1.

### **Modification 0571A**

Mandated Daily Metered (DM) customers are subject to a number of different UNC rights and obligations relative to their status as DM customers. Additional customers who wish to operate under the DM arrangements are free to do so under the current rules by electing into DM arrangements and they are then subject to the same rights and importantly, the same restrictions as other DM customers; and ultimately if a customer then finds the DM regime onerous they are free to return to their non-mandatory status as NDM customers and avoid the risks of operating under these arrangements.

Shippers will be able to choose a settlement classes that offers the equivalent of daily metered arrangements (where there is a suitable meter installed that collects daily metering data) but the customer could have a very low gas demand.

Customers who are elected into Settlement Class 2 by their Shipper will have to operate within the requirements of that settlement class which includes, amongst other things, them setting their own capacity requirements with the networks and being subject to any consequences for exceeding it or getting it wrong.

It is believed that the original expectation in creating Settlement Class 2 was that it would attract the same larger customers, who had advanced metering, that elected to be treated as traditional DM customers today, and that smaller customers with advanced or smart metering would be elected into Settlement Class 3 where they would benefit from the use of their daily meter readings in settlement processes with individual meter point reconciliation, but they would have their capacity determined – derived from their consumption information, irrespective of their designation as a SSP or LSP NDM supply point.

Under the current design for Settlement Class 2, all customers within the class will be required to forecast their demand and agree their SOQ, which will also drive their transportation charges, so there is a risk that if smaller customers with only a domestic-sized demand are elected into this class with no experience of operating in this way that they may find themselves exposed to costly ratchet charges for exceeding their booked capacity if they are exposed to an unforeseen weather event that sees them temporarily increase their heating load on the coldest days (which may be only a very short period).

If they lack information and/or experience in forecasting their expected capacity requirements this could lead them to incurring higher transportation charges by over-estimating their SOQs, which may not be identified quickly, and of course, once a supply point has ratcheted the SOQ is rebooked and transportation charges will rise in line with the new SOQ at the appropriate point in the year, which may actually only be a 1 in 20 event.

Any supplier that elects their domestic-sized customers into Class 2 would also have to explain the ratchet regime to their customers so that they are fully informed of the potential consequences of being elected into Class 2. It could be argued that Shippers can avoid this risk by electing the customer into settlement Class 3 where ratchet charges don't apply because their SOQ is derived from their consumption information directly; however this could be perceived as a barrier for shippers operating mixed portfolio supply points in any of the 3 non-mandatory settlement classes.

In a recent Ofgem decision relating to Ratchets<sup>1</sup>, Ofgem recognised the importance of ratchets in incentivising Shippers to accurately determine the supply point capacity and their relationship to accurate transportation charges.

Modification 0571A is not seeking to restrict customer choice; it merely seeks to ensure that there are adequate safeguards for both the customer and the networks in the treatment of capacity booking and the consequences for getting it wrong.

The case for DM Mandatory status is not driven by a settlement requirement, DM reading equipment provides the Network Operators and the System Operator with daily information relating to the operation of the network, which ensures supply is maintained to a safe level, with particular regard for small supply points that would have to be individually purged and relit in the event of a loss of supply – an onerous and expensive task. The DM regime requires large customers to set their SOQ to reflect their peak demand and the DM data provides information that enables the network operators to monitor the demand and ensure they make sufficient demand available at those peak times, resulting in the efficient operation of the pipeline system, which itself is a GT licence condition, and facilitation of these licence conditions is a requirement of any code modifications.

The 2 million therms limit requiring customers to become DM mandatory is set as national threshold and may not be appropriate in all instances and across all parts of the network. Where individual parts of the network may have local constraints, the use of ratchets can support specific active network management as opposed to network reinforcement, which may be more expensive in the longer term. The DNs incentivise regime encourages customers who elect to operate in the DM regime to actively manage their capacity, revising it as necessary to reflect any flexing of their peak demand, so as to enable the network operators to protect the wider network.

Project Nexus did not undertake an assessment of the adequacy of the DM mandatory threshold, nor did it have any regard to it when setting out the requirements for any of the Settlement Class Products developed. The treatment of product class under the new rules preserves the existing DM mandatory requirements (using Product Class 1); Product Class 2 continues to facilitate a regime where customers can elect into the same elective DM regime as today, it requires the customer to operate in the same way as if they were mandated DMs in all ways, and not just how frequently they can provide a meter reading. Product Class 3 was developed to accept batched daily obtained metering readings for smart/advanced meters in to settlement, but does not envisage customer's managing their capacity requirements directly, nor did it not set any capacity thresholds, meaning that it can be used by all supply points up to the DM Mandatory threshold, allowing the utilisation of daily metered data for settlement integrity for sites with suitable meters.

The question arises whether it is appropriate to discriminate against a class of customer in their treatment under the rules set out in the network code. The application of a threshold for treatment of customers is a well-established and common approach within the code and also exists in other energy legislation. There are rules which are based on achieving objectives that are generally set out by the Regulator in the licences or under policy developed by government.

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<sup>1</sup> <http://www.gasgovernance.co.uk/sites/default/files/Ofgem%20Decision%20Letter%200551.pdf>

The very definition of a DM Mandatory threshold is itself a limit under which we treat customers differently from each other, and in setting a threshold we determine that all customers above or below it shall have different treatment according to a set of principles or rules set out in the code – for example

- Customers are split into DM and NDM based on an arbitrary split of their capacity levels across the UK network – we do not apply site specific rules based on the ability of the local network operator to manage any capacity issues; we read very large customers daily (DM), we read large NDM on a monthly basis (NDM LSPs), and sites below 73,200 kWhs annually (NDM SSPs).
- AOs are managed differently, depending on whether they fall above or below a threshold, today an NDM LSP site's AO can be appealed at any point in the year, however a domestic level NDM SSP site with an AO below 73,200 kWhs can only be revised during the Annual AO Review process, because the movement in their capacity individually at any point in the year (but particularly at times of peak network demand) is not deemed to be sufficiently material as to require the network operator to be immediately made aware of it.
- There is legislation that looks to treat smaller customers as a class and protect them from more onerous requirements where the benefits are marginal or indistinguishable at an individual level. The Gas Calculation of Thermal Energy Regulations 1996 for example discriminates in the treatment of customers above and below the 73,200 kWhs threshold – those below the threshold have general class-wide principles applied, where those above this threshold have site specific treatments applied, because the impact of site specific correction factors at this lower capacity level is deemed as immaterial to the operation of the pipeline network.
- There are many protections applied in the GT, Shipper and Supplier Licences that require specific services for domestic customers – such as the obligations to appoint a meter asset manager for domestic customers, but not business customers; the recovery of costs for provision of connection of gas services to domestic customer; treatment of customer in loss of supply situations.

In determining a threshold of 73,200 kWhs rather than a supply class, this modification relies on the treatment of site capacity, which has been used throughout the Code, and in other legislation as an appropriate measure for grouping customers into a class and applying specific rules to that group. Ofgem and other government departments regularly treat 73,000 kWhs as the threshold definition of a domestic customer/premise in the reports they publish on consumption, rather than the Domestic or Industrial indicators that are sometimes used and which Ofgem and network operators have previously expressed concern that they are subjectively applied, inaccurate in many cases and cannot be validated. The use of the kWhs level is a verifiable and precise limit to apply business rules against and should make it easier to identify which customers may have to actively manage their capacity – since its capacity based.

It seems entirely reasonable therefore to not apply the ratchet charges to a small supply point customer whose demand may be temporarily affected by an unforeseeable event whilst at the same time protecting the network from the potential risk posed by larger customers. It is hard to argue that customers with this lower level of capacity can have a detrimental impact on the network operation, even collectively, however, should this be the case, then the network operator must consider whether the use of incentives is an inappropriate mechanism to manage that specific risk.



### 3 Solution

#### Modification 0571

It is proposed 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.

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

#### Modification 0571A

It is proposed that Ratchets Charges should be limited to all Class 1 Supply Points and to Class 2 Supply Points with an AQ which exceeds 73,200 kWhs. UNC TPD B 4.7 should be amended to limit the scope of Ratchet Charges to these Supply Points.

User Pays	
Classification of the modification as User Pays, or not, and the justification for such classification.	<p><b>0571</b> and <b>0571A</b> – These modifications propose amendment to an existing ratchet incentive regime as it is proposed to restrict Ratchets Charges to Class 1 (0571) or Class 1 and Class 2 with an AQ exceeding 73200kWhs (<b>0571A</b>). Therefore no new User Pays service is being created or amended as the existing process for suppressing Ratchet Charges can be used.</p> <p>Some Workgroup participants disagreed with the view that these modifications should not be classified as User Pays, as the changes proposed were not included in the BRDs establishing Project Nexus requirements and should be considered as changes to these requirements. Therefore these modifications should be considered User Pays and funded by Shipper Users as they are the main beneficiaries.</p>
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.	<p>Some Workgroup participants considered that as these modifications relate to the operation of an incentive that protects the network operator from inefficient operation of the network, that the costs to suppress the invoicing of ratchet incentive payments should be borne by the network operators. It would seem incongruous to charge customers for not invoicing them in certain circumstances.</p>



Proposed charge(s) for application of User Pays charges to Shippers.	Transporters were unable to provide a ROM as the changes proposed relate to Project Nexus systems, which are to be implemented at a later date. However, Xoserve has shared a High Level Cost estimate with Transporters but not other Workgroup participants, and a verbal update advised that costs are likely to be in the range of £100k to £300k for a system built solution.
Proposed charge for inclusion in the Agency Charging Statement (ACS) – to be completed upon receipt of a cost estimate from Xoserve.	Transporters have provided a draft ACS for each modification.

## 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.	Impacted 0571 Positive 0571A
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 – 0571 and 0571A
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.	Impacted - 0571 and 0571A
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

Some Workgroup participants considered that by restricting Ratchets Charges to Class 1 (0571) or Class 1 and Class 2 with an AQ exceeding 73200kWhs (0571A), the changes proposed in these modifications would avoid the setting of potentially inflated SOQ values against Supply Points to ensure that ratchet charges are avoided. This would reduce inflated SOQs and avoid the need for unnecessary or early network reinforcement, due to freeing up of sterilised capacity and the establishment of more accurate SOQs. Therefore furthering relevant objective a) Efficient and economic operation of the pipe-line system.

Some Workgroup participants considered that as more Supply Points become Class 2, more are likely to ratchet if the current regime is left unchanged. This is likely to lead to an increase in the number of queries raised and resulting charge suppressions where the charge has been raised in error, therefore these modifications would potentially reduce the number of queries raised and its associated administration burden and further relevant objective f) Promotion of efficiency in the implementation and administration of the Code.

### **Modification 0571**

This modification ensures that the behaviour Ratchet charges 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).

Some Workgroup participants considered Modification 0571 could impact the Transporter's ability to accurately assess system offtake quantities in line its obligations in UNC TPD G5.5, as there would be no commercial incentive on consumers to control their system offtake capacity in line with contracted limits and this would impact the Transporter's ability to manage its network efficiently, therefore impacting relevant objective a) Efficient and economic operation of the pipe-line system.

### **Modification 0571A**

Some Workgroup participants considered this modification better targets the Ratchet incentive regime that is operated by the network operator to mitigate their capacity risks, and therefore facilitates relevant objective a) Efficient and economic operation of the pipe-line system.

This modification ensures that the behaviour Ratchet charges incentivise, apply only to larger consumers and that, as a result, Class 2 will be available without the disproportionate impact of the Ratchet Charge regime being applied to Small Supply Points in Class 2 (73,200kWhs or less), 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.

## 6 Impacts

### Do these modifications impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

Although it would be beneficial if these modifications were implemented soon after the Project Nexus Implementation Date, the changes proposed would have no impact on Project Nexus implementation.

### Workgroup Supplemental Report

The Workgroup is requested to consider and report on the following questions identified by Panel.

Q1. Consider the issues around the potential incentive to understate SOQ values identified in SSE's representation (relating to 0571A) and determine whether changes to the Solution are required.

Q2. If necessary, provide a Variation Request and a recommendation on its materiality.

## 7 Legal Text

### Text Commentaries

#### Modification 0571

##### Notes

1. The table is based on the legal drafting for Modification 0571 submitted by NGGD to the Joint Office on 02 June 2016.
2. Modification 0571 recognises the introduction of the new classes of Supply Points under Project Nexus and the wider availability of daily read sites with lower AQs. The modification limits the application of Ratchet Charges to Class 1 Supply Points whose operation may be material to the safe operation of the Network.
3. Modification 0571 will modify TPD Section B (System Use & Capacity).

Paragraph	Explanation
<b>Modification 0571: Legal Text</b>	
<b>AMENDMENT TO TPD Section B: System Use and Capacity</b>	
Amended paragraph 4.7.1	Includes additional wording to clarify that the Supply Point Ratchet Charge will apply to 'a Class 1 Supply Point' only.

#### Modification 0571A

##### Notes

1. The table is based on the legal drafting for Modification 0571A submitted by NGGD to the Joint Office on 02 June 2016
2. Modification 0571A recognises the introduction of the new classes of Supply Points under Project Nexus and the wider availability of daily read sites with lower AQs. The modification limits the application of Ratchet Charges to Class 1 Supply Points and Class 2 Supply Points, with an AQ, which exceeds 73,200kWh, whose operation may be material to the safe operation of the Network.
3. Modification 0571A will modify TPD Section B (System Use & Capacity)

Paragraph	Explanation
Modification 0571A: Legal text	
Amendment to TPD Section B: System Use and Capacity	
Amended paragraph 4.7.1	Includes additional wording to clarify that the Supply Point Ratchet Charge will apply to 'a Class 1 Supply Point or a Class 2 Supply Point with an AQ which exceeds 73,200kWhs only.

## Texts

The following Texts have been prepared by National Grid Gas Distribution and no issues were raised by the Workgroup regarding their content.

### Text for Modification 0571

#### 4.7 Supply Point Ratchet

4.7.1 Subject to paragraph 1.3.2, and paragraphs 4.7.8, 4.7.9 and 4.7.10 and 4.7.12 if for any reason:

- (a) in respect of a DM Supply Point (other than a Seasonal Large Supply Point) on any Day, other than a Day in the months of June to September inclusive, or
- (b) in respect of a Seasonal Large Supply Point, on any Day,

the quantity of gas offtaken by a User from the Total System at a DM Supply Point exceeds the User's Registered DM Supply Point Capacity (such occurrence being in each case a "**Supply Point Ratchet**"), then:

- (i) in each such case ~~(i)~~ the User's Registered DM Supply Point Capacity at that Supply Point shall automatically be increased with effect from the following Day in accordance with paragraph 4.7.3; and

- (ii) subject to paragraph 4.7.11, in the case of a Class 1 Supply Point the User shall pay a charge ("**Supply Point Ratchet Charge**") in respect of the Capacity Ratchet Amount in accordance with paragraph 4.7.6.

## Text for Modification 0571A

### 4.7 Supply Point Ratchet

4.7.1 Subject to paragraph 1.3.2, and paragraphs 4.7.8, 4.7.9 and 4.7.10 and 4.7.12 if for any reason:

- (a) in respect of a DM Supply Point (other than a Seasonal Large Supply Point) on any Day, other than a Day in the months of June to September inclusive, or
- (b) in respect of a Seasonal Large Supply Point, on any Day,

the quantity of gas offtaken by a User from the Total System at a DM Supply Point exceeds the User's Registered DM Supply Point Capacity (such occurrence being in each case a "**Supply Point Ratchet**"), then:

- (i) in each such case ~~(i)~~ the User's Registered DM Supply Point Capacity at that Supply Point shall automatically be increased with effect from the following Day in accordance with paragraph 4.7.3; and
- (ii) subject to paragraph 4.7.11, in the case of a Class 1 Supply Point or a Class 2 Supply Point with an AQ which exceeds 73,200kWh the User shall pay a charge ("**Supply Point Ratchet Charge**") in respect of the Capacity Ratchet Amount in accordance with paragraph 4.7.6.

## 8 Consultation Responses

The summaries in the following table(s) are provided for reference on a reasonable endeavours basis only. It is recommended that all representations be read in full when considering this Report.

### Modification 0571

Of the 11 representations received, 4 supported implementation, and 7 were not in support.

### Modification 0571A

Of the 11 representations received, 1 supported implementation, 2 offered qualified support, and 8 were not in support.

## Preference expressed

Of the 11 representations received, 4 expressed a preference for **0571**, 6 expressed a preference for **0571A**, and 1 stated that neither was preferred.

Organisation	Response	Relevant Objectives	Key Points
British Gas Trading	<p><b>0571</b> Support</p> <p><b>0571A</b> Oppose</p> <p><b>Prefer</b> <b>0571</b></p>	<p>a - positive</p> <p>d - positive</p> <p>f - positive</p>	<ul style="list-style-type: none"> <li>• Agrees should not be self-governance, as will have a material impact on consumers.</li> <li>• Observes that ratchets are a historic, non-cost reflective mechanism to incentivise large site capacity bookings to be accurate in capacity booking. In practice customers book additional capacity to avoid risk of penalty charges; this is not a good economic use of the system and stops unused capacity being realised into the market. Notes that Post Nexus implementation ratchets will be applied to Product Classes 1 and 2 (PC 1 and PC 2), and changes in metering technology mean that daily read customers will soon include domestic customers, micro- business as well as medium sized industry and commercial customers.</li> <li>• Does not believe that ratchets were originally envisaged to be applied to these customer types. Through the new Nexus arrangements ratchets probably should have been mapped to PC 1 only. The application of ratchets to PC 2 will act as an obstacle for any daily read customer (including Smart and AMR), nominating into PC 2 and to fully utilising the benefits of improved data granularity provided by daily readings.</li> <li>• <b>0571</b> - Supports implementation of 0571 to ensure capacity does not get unnecessarily tied up by PC 2 customers wanting to protect themselves from penalty ratchet charges, to ensure the full utilisation of all Nexus product classes, to ensure the industry operates with the most granular level of data to deliver settlement and allocation benefits and to stop a penal charge incorrectly being applied to small and medium sized daily read customers.</li> <li>• Removing the penalty ratchet charge removes a significant barrier to the utilisation of more granular settlement classes, driving greater utilisation of energy settled under PC2. Should result in more accurate consumption information and cost allocation, which will reduce volatility associated with smearing factors and therefore ultimately reduce market risk premiums.</li> <li>• Sees a number of benefits. Increased uptake of PC 2/frequency of daily data will help customers manage their energy more effectively and help to identify unallocated gas cost more quickly. Full utilisation of PC 1 and PC 2 and the use of more daily data will help networks to manage their pipeline infrastructure more effectively.</li> <li>• Believes that failure to implement 0571 will risk daily metered capable customers nominating into PC 4, which will result in more unallocated or unreconciled gas</li> </ul>

			<p>volumes, which reduces the benefits of delivering Nexus.</p> <ul style="list-style-type: none"> <li>• <b>0571A</b> - Believes that introduction of a ratchet safe zone in an attempt to protect domestic customers severely limits any settlement and allocation benefits and is also discriminatory towards domestic customers who consume more than 73,200kWh.</li> <li>• Does not believe that the removal of the ratchet charge will restrict Transporters' ability to manage restraints on their networks. Greater use of PC 2 will provide more granular daily read data that will help Transporters manage their networks. Modification 0571 maintains the "overrun" mechanism; this will increase the customer SOQ and apply the appropriate charging to the customer should their capacity be under booked. As a result there is no gain to artificially reduce capacity, especially when considering the risk of losing the pipeline capacity. If concerns remain, notes that the Performance Assurance Committee can monitor capacity booking activity and Modification 0445 allows for an 'incentive factor' above 1 to be introduced.</li> </ul>
<p><b>Corona Energy</b></p>	<p><b>0571</b> Support <b>0571A</b> Oppose  <b>Prefer</b> <b>0571</b></p>	<p>a - positive d - positive f - positive</p>	<ul style="list-style-type: none"> <li>• Agrees should not be self-governance as will have a substantial impact on the rollout of daily read functionality across the market.</li> <li>• Implementation should coincide with Project Nexus to avoid delaying the rollout of daily read status to those customers who can benefit. Sees no reason why the changes for <b>0571</b> cannot be delivered as part of Project Nexus, considering the straightforward nature of the solution.</li> <li>• Recognises the historical reasons for the original ratchet regime but given the steady falling away of peak demand, reduced system constraints, and large reduction in number of daily read sites, questions why Network management concerns have only now arisen. Despite this loss in visibility of peak demand, Transporters have never indicated any concern that most large industrial sites are not daily metered and are instead happy to rely on an estimation algorithm to determine peak daily demand.</li> <li>• Notes that at the advent of Project Nexus, Transporters will have no ability to require a site to become daily metered as the Network Sensitive Load (NSL) process will be removed, and comments that it is therefore curious that Transporters have raised concerns now over the fact that many sites that have no oversight of their peak gas demand would not be subject to the ratchet charges if they choose to become daily read. Would have expected some form of remedy to have been brought forward by now if these concerns had any merit.</li> <li>• Observes that both modifications leave the process for adjusting SOQ in place so ensuring that the SOQ is accurate if a site's SOQ is breached on a single day.</li> <li>• Considering it is proposed that the SOQ will still be increased if a site's consumption does exceed the registered capacity, far from being a threat to good network management, <b>0571</b> will address the current issue for daily read sites, where the SOQ is set artificially high to avoid the risk of ratchet charges (giving an inflated view of peak demand and with higher network management costs ultimately then paid by consumers). By contrast <b>0571A</b> will</li> </ul>



			<p>not, except at the very bottom end of the market, and so this will mean it will not address this issue to any great degree.</p> <ul style="list-style-type: none"> <li>• Believes there to be no reason why a site that is daily read (PC 2) should be exposed to a penal charge regime, when an identical site is not if it is non-daily read (PC 3). There is also no logic or justification for the clear discrimination introduced in the arbitrary dividing line which <b>0571A</b> proposes.</li> <li>• Believes a substantial portion of the benefits associated with the rollout of advanced and smart metering can only be realised if there are no penal barriers to customers becoming daily settled; the penal nature of the ratchet charge regime is the only substantial barrier that exists. <b>0571</b> removes this barrier, but <b>0571A</b>, by significantly limiting the number of customers who can benefit from this change, significantly reduces the benefits of changing the current regime to the point where it is believed it is negligible.</li> <li>• The current ratchet regime will require management of substantial numbers of SOQs for sites with low consumption, were Corona to attempt to capture the benefits of the AMR devices it has installed at a majority of its sites. The level of administration to manage such SOQs will be considerable and the level of financial risk associated with a an SOQ is likely to dissuade Corona from reclassifying sites as PC 2, even if their consumptions levels approach the current DM threshold. <b>0571</b>, by removing this financial risk, will therefore result in substantial saving for customers as it will reduce the administrative burden of continually monitoring SOQs for large numbers of sites and allow large numbers of sites to move to PC 2; this will allow customers to capture the benefits of more frequent settlement. This will reduce risk in the market by improving cost apportionment.</li> <li>• <b>0571A</b>, by restricting its benefits to the smallest sites in the market, will prevent these benefits from being delivered to those where it makes the greatest impact - SME and industrial sites with large consumptions. Corona therefore sees no benefit from <b>0571A</b> as the benefit for these smallest customers is negligible.</li> </ul>
<p><b>E.ON Energy Solutions Ltd</b></p>	<p><b>0571</b> Oppose <b>0571A</b> Qualified Support  <b>Prefer</b> <b>0571A</b></p>	<p>a - positive d - positive - <i>disagrees</i> f - positive and b - <i>believes to be negative</i></p>	<ul style="list-style-type: none"> <li>• Agrees should not be self-governance.</li> <li>• Implementation should coincide with that of Project Nexus.</li> <li>• Expresses different views regarding relevant objectives (d) and (b).</li> <li>• <b>Relevant objective (b)</b> - Believes this is also impacted – negatively. Exempting consumers from ratchet charges would not incentivise consumers to set their SOQ to meet their use when demand is at the highest and could result in a network operator not making sufficient capacity available to meet demand in peak flow conditions. This could result in inefficient operation of the pipeline system of one or more of the Transporters.</li> <li>• Believes there to be three questions: <ol style="list-style-type: none"> <li>1. If users can set their own capacity should they expect to behave more responsibility than those who can't;</li> <li>2. Should all customers with daily reading capable meters</li> </ol> </li> </ul>

			<p>be treated equally, and</p> <p>3. If customers can determine their own capacity, should they be subject to an incentive regime that helps drive the right behaviour and mitigate the risk to others network users.</p> <ul style="list-style-type: none"> <li>• Networks are sized according to predicted demand – based on a number of factors (e.g. historic usage and an understanding of the needs of their customers). Unreasonable/ unplanned usage by individual consumers can place constraints on the ability of the DNO to continue to provide security of gas supply to all other users on their network. Ratchets are a control mechanism that are used to manage the networks’ security of supply risks by exerting controls which provoke users to engage with the networks to collaboratively plan future demand requirements, ensuring that everyone’s network access is protected.</li> <li>• UK Link Replacement together with advanced and smart meters reading capability provided an opportunity that has not existed before - access to a daily metered settlement product for even the very smallest of customers. Under the current rules, customer may only elect to be a DM customer in the event that their AQ exceeds 732,000 kWhs. Electing to become a DM customer today requires the customer to operate with all the existing rights and more importantly the obligations of a DM mandatory customer, including setting their capacity directly with their DNO. In future the settlement arrangements will not be determined by capacity, but by meter reading capability, however the customers at either end of the spectrum of this Class can impact the networks very differently and it is appropriate to discriminate between them. Domestic sized customers would never expect to have the same detrimental impact on the network by exceeding their capacity that a large user may have. Domestic sized customers have no experience of determining their capacity needs, so having to set out the ratchet risk to these customers may result in them being nervous about using heat when its particularly cold (and this may particularly impact vulnerable customers) or suppliers taking action to avoid the risk entirely by overstating capacity by a margin (which would be detrimental to the networks as it may lead to unnecessary work) and/or building in risk premiums to customer contracts to provide for the ratchet risk. It is also not clear that a customer or their supplier can elect which settlement class the Shipper may use and therefore the customer may not be able to avoid the risk.</li> <li>• <b>Relevant objective (d)</b> - In an earlier decision (for 0551) Ofgem believed that removing the Ratchet charges incentive would not result in more accurate transportation charges, since Ratchets incentivise the accurate determination of capacity, which results in more accurate transportation charges. Removing the link between the booked capacity and the incentive would actually seem to be detrimental to relevant objective (d).</li> </ul>
<p><b>Gazprom Energy</b></p>	<p><b>0571 Support</b></p>	<p>a - positive d - positive</p>	<ul style="list-style-type: none"> <li>• Agrees should not be self-governance, as will have a material impact on commercial arrangements between customers and suppliers (and, by extension, Shippers).</li> </ul>

<p><b>0571A</b></p> <p>Oppose</p> <p><b>Prefer</b></p> <p><b>0571</b></p>	<p>f - positive</p>	<ul style="list-style-type: none"> <li>• Implementation should be concurrent with Nexus implementation, to avoid delaying the rollout of daily read status to those customers who can benefit. As the solution does not require a system change to deliver, there is no reason why these changes cannot be delivered in good time.</li> <li>• Notes the decline in peak demand and significant changes to market since introduction of original regime and that capacity in networks is now virtually unconstrained (as evidenced by removal of capacity management tools). Believes Transporters have access to other more immediate tools to manage any occurring 'real-time' risk. Application of retrospective charges is not such a tool.</li> <li>• Observes there has been a steady reduction in number of daily read sites, and that Nexus will introduce new arrangements/further market changes. Believes retention of a legacy penal ratchet charge regime will have adverse effects, and gives examples.</li> <li>• Points out the inequity between similar sites that may arise when a customer/Shipper can choose the site's own metering frequency and there is no mechanism for the explicit setting of a site's peak consumption.</li> <li>• <b>0571</b> - Will improve the ability for Transporters to accurately manage their networks by removing any unnecessary penal Ratchet Charges for utilising more granular settlement services. The ultimate aim for network management is that customers provide accurate SOQs. The current daily read ratchet charge regime actively encourages over-estimation of peak system needs as Shippers and consumers have to err on the side of caution to avoid these penalty charges (resulting in sterilization of capacity and an inflated view of peak gas requirements, leading to inefficient investment in unnecessary additional network capacity).</li> <li>• With the rollout of advanced and smart metering it is estimated that £839m will be network benefits. A substantial portion of these benefits can only occur/be realised if there are no penal barriers to customers becoming daily settled, so allowing the increased granularity of site consumption to flow through to settlement, improving cost allocation and reducing settlement risk.</li> <li>• Removal of this penal ratchet charge removes a potential significant barrier to the utilisation of more granular settlement classes. The benefits from daily read sites is scalable; the larger the site's annual consumption, the larger the benefit from improved accuracy. The more consumption that is settled under PC 1 and 2 the greater the reduction in volatility associated with the smearing factors, which are used to manage unallocated consumption (the period for which consumption is incorrectly allocated via smearing will reduce as correct information will be available more quickly, i.e. daily versus monthly, six monthly, annually, etc). This increased certainty will aid more accurate cost allocation and reduce risk premiums in the market.</li> <li>• Believes implementation will facilitate a substantial saving for customers, as it will firstly reduce the administrative burden of calculating SOQs for large numbers of sites as they move towards daily read status, and secondly remove</li> </ul>
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			<p>the need to continually appeal sites that breach them. It will also remove a significant barrier to sites becoming daily read, so ensuring that the benefits of more frequent settlement for customers are captured. This will reduce risk in the market by improving cost allocation and so benefit customers.</p> <ul style="list-style-type: none"> <li>• <b>0571A</b> - Believes there is no logic in the dividing line between customers that <b>0571A</b> seeks to introduce. By significantly limiting the number of customers who can benefit from this change, it significantly reduces the benefits of changing the current regime to the point where it is believed it is negligible in the short to medium term, as the number of these sites with Advanced or Smart Metering fitted and able to benefit is far smaller in proportion to the rest of the market where Advanced and Smart are more prevalent.</li> </ul>
<p><b>National Grid Gas Distribution Ltd</b></p>	<p><b>0571</b> Oppose <b>0571A</b> Oppose</p> <p><b>Prefer</b> <b>Neither</b></p>	<p>a - negative d - none f - none</p>	<ul style="list-style-type: none"> <li>• Agrees should not be self-governance these modifications would have a material impact on the contractual arrangements between Suppliers and Consumers, and also on the commercial arrangements between Transporters and Shippers.</li> <li>• Does not agree regarding the relevant objectives.</li> <li>• Observes that as a Transporter, security of supply is of the utmost importance to ensure system integrity and to protect gas customers, and does not believe either proposal better serves this interest and potentially, encourages inefficient behaviours with regard to increases in load and ultimately the effect of this on the Network. Having an integrated LDZ Exit Capacity regime in place facilitates the Network Operator's ability to maintain supplies to 11 million gas customers, and it is believed both modifications, to some extent, compromise the integrity of these arrangements.</li> <li>• Observes that although the long term trend for the consumption of gas is downward, Peak Day demands can, and do increase from year to year. Transporters have a number of forward looking tools at their disposal. The use of Ratchet Charges is an after-the-day tool, designed to be a deterrent to a localised overrun, and the use of such an incentive has proved effective at encouraging the desired behaviour, so should continue to be used at MPRN level.</li> <li>• Is concerned that removal of the charge would represent a dilution of well-established UNC arrangements and potentially undermines their effectiveness. Without the presence of the incentive, believes little attention would be paid to the calculation of an accurate SOQ. It is not only the larger Supply Points that potentially pose a risk to the Networks by overrunning. Smaller Supply Points that are situated on sensitive sections of the System can have a detrimental impact when taking higher than anticipated flows without authorisation.</li> <li>• <b>0571A</b> - Believes that the approach taken in <b>0571A</b> potentially discriminates against certain categories of DM customer by selectively dis-applying the Ratchet incentive.</li> </ul>
<p><b>Northern Gas Networks</b></p>	<p><b>0571</b> Oppose <b>0571A</b></p>	<p>a - negative d - negative f - negative</p>	<ul style="list-style-type: none"> <li>• Agrees should not be classed as self-governance due to material effect on parties.</li> <li>• Implementation would need to be no earlier than Project Nexus. As there would need to be a lead time for the</li> </ul>

	<p>Oppose</p> <p><b>Prefer</b> <b>0571A</b></p>		<p>necessary changes to be made to the central systems a firm timetable is not currently available.</p> <ul style="list-style-type: none"> <li>• Does not agree regarding the relevant objectives.</li> <li>• Believes the current ratchets regime incentivises nomination of realistic peak-day demands. This is important to efficiently manage the physical system and for carrying out future demand estimation activities. Transporters' systems continue to operate with physical constraints in some geographic areas, which requires active management.</li> <li>• Observes that under the RIIO incentives, Transporters have been reducing their bookings from the NTS, which in turn releases this capacity to other direct NTS users. These lower NTS bookings mean that while in some areas there may be physical capacity in the pipeline, the Transporter is not able to offtake unplanned increased capacity from the NTS.</li> <li>• Post Project Nexus implementation, the number of PC 1 sites will be a reduction from the current level of DM sites, and near real time monitoring of larger loads will be for a smaller number of supply points. It will remain important for these larger loads in PC 2 to nominate appropriate and realistic SOQs in order to facilitate network planning and day to day management. Transporters will not have direct access to PC 2 site data under the revised arrangements, and will therefore need to rely on nominated SOQs for demand signals that feed into their investment programmes.</li> </ul>
<b>npower</b>	<p><b>0571</b> Oppose</p> <p><b>0571A</b> Support</p> <p><b>Prefer</b> <b>0571A</b></p>	<p>a - positive d - positive f - positive</p>	<ul style="list-style-type: none"> <li>• Agrees should not be classed as self-governance as they have a material impact on customers.</li> <li>• Notes that ratchet charges have been in place for many years helping ensure security of supply.</li> <li>• Believes removing ratchet charges totally from PC 2 would place unnecessary risk to the industry as it would contain many DM sites.</li> <li>• Believes ratchet charges should not be applied to domestic customers, and therefore <b>0571A</b> satisfies both of these concerns.</li> </ul>
<b>Scotia Gas Networks</b>	<p><b>0571</b> Oppose</p> <p><b>0571A</b> Oppose</p> <p><b>Prefer</b> <b>0571A</b></p>	<p>a - negative d - none f - negative</p>	<ul style="list-style-type: none"> <li>• Agrees should not be classed as self-governance as they have material impacts upon the safe and efficient operation of the network, and also upon the commercial arrangements between Transporters, Shippers and end consumers.</li> <li>• Implementation timescales of either Modification should take into account the relative industry priorities, and therefore should not cause the diversion of any resources from the delivery and post-implementation support of Project Nexus.</li> <li>• Does not agree regarding the relevant objectives.</li> <li>• Reviewing all factors it believes it cannot support any restriction of the ratchets regime.</li> <li>• Considers the application of the Ratchets regime, including the associated charges, to PC 1 and 2 sites, to be appropriate and proportionate. Does not consider that any evidence has been presented to demonstrate a</li> </ul>

			<p>material change in industry circumstances that justifies the restriction of an existing regime.</p> <ul style="list-style-type: none"> <li>• Draws attention to Licence Condition SC A16 (and to Ofgem’s decision letter for Modification 0551), noting that the existing methodology for satisfying this licence condition has been developed and applied on the basis of the ratchets regime being in place to its full extent; restriction of the ratchet regime is likely to result in a significant change in network management methodology being taken going forwards.</li> <li>• Notes an intrinsic link between SOQs and network capacity; the former providing effective market signals to inform the latter. This market signal is especially important on single-fed lines such as those commonly seen on the Scottish distribution network (a more detailed profile of which is provided in the representation).</li> <li>• Is concerned that by reducing the incentive on customers and Shippers to accurately forecast their SOQs, an increase in under-estimated SOQs will be received, creating inaccurate market signals, and which risks undermining the safety and stability of the network.</li> <li>• Believes that the generalised view of a national decline in gas consumption equating to an unconstrained network is flawed, and does not take into account geographically specific areas of the network where demand exceeds capacity (example provided).</li> <li>• Observes that an overall decrease in consumption does not equate to a smoothing of load profile, and therefore the necessity to carefully manage the risk associated with peak consumption persists.</li> <li>• Refutes the assertion that the removal of interruptible supply contracts is further evidence of an unconstrained network. The mechanism to offer these contracts on a voluntary basis continues to exist, demonstrating the ongoing presence of constrained areas (example provided).</li> <li>• Notes that approximately 10% of large customers incurred ratchet charges in the winter of 2015/16, demonstrating that accurate management of SOQs persists as a difficulty for many users and therefore that the regime is required to remain in place.</li> <li>• Believes that real-time monitoring does not replace good behaviour and that such monitoring, whilst helping to swiftly identify an issue, will not prevent an on-the-day supply emergency caused by capacity being over-utilised on a constrained part of the network.</li> <li>• Points out the Ratchets regime is the only incentive currently in place to encourage accurate management of SOQs. An unexpected increase in consumption by one consumer within a constrained area would have significant implications on the security of supply for surrounding customers and would also have significant impacts upon the consequent safety of the network. The latter is of primary importance and the restriction of the Ratchets regime would place unacceptable risk upon the safe operation of the networks.</li> <li>• Refers to impacts on availability of Up-Stream Capacity. An unanticipated use of excess capacity, beyond that</li> </ul>
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			<p>reserved, could cause the distribution network to require a short-notice increase in capacity from the associated Local Transmission System (LTS) network, likely triggering a consequent request from the NTS network. The absence of any prior indication of capacity requirements, such as the management of appropriate SOQs, would result in such requests being outside of the required capacity forecasts, which could lead to such capacity being unavailable, or reinforcement being considered.</p> <ul style="list-style-type: none"> <li>• Agrees that enhanced availability and use of granular data will be of benefit to the industry, with both Smart and Project Nexus providing good opportunities to improve against the current position, and welcomes the four new settlement classes and the opportunity they offer in terms of access to Daily Metered arrangements, especially in the case of domestic Smart consumers.</li> <li>• Does not consider that the presence of the Ratchets regime is an inhibitor to the use of any Class and therefore to the provision of more granular data. Given the settlement benefits opportunities which the higher Classes provide, including Shippers self-nominating their SOQs, considers that the application of the Ratchets regime is a fair balance, providing protection to the network organisations who otherwise have little control of the nominated capacity values.</li> <li>• Suggests that the new settlement regime delivered by Project Nexus should be subject to a bedding-in period to establish some reliable performance trends, before an assessment of the success or otherwise of the Classes, and therefore amendments to their design, are made.</li> <li>• Has provided additional information in the form of a worked example to demonstrate the significant impact upon network pressure as a result of an incremental increase in consumption (see representation).</li> </ul>
SSE	<p><b>0571</b> Oppose <b>0571A</b> Qualified Support</p> <p><b>Prefer</b> <b>0571A</b></p>	<p>a - negative d - negative f - negative</p>	<ul style="list-style-type: none"> <li>• Agrees should not be classed as self-governance.</li> <li>• Implementation should be as soon as possible.</li> <li>• Does not agree regarding the relevant objectives.</li> <li>• <b>0571</b> - Does not support this as feels that the limit below which ratchet charges are avoided is too high and that Shippers should be able to set realistic SOQ values with daily information and be capable of re-nominating capacity at the earliest opportunity.</li> <li>• <b>0571A</b> - Whilst agrees with intent that domestic and smaller I&amp;C sites should not be subject to Ratchet charges, notes there is nothing within the modification that puts any requirement on Shippers to nominate realistic SOQ values, and so cost benefits could be gained from deliberately underestimating the initial SOQ values during the first year of registration into PC 2 (example provided). Believes there would always be the incentive to understate the SOQ as there would be no incentive to get it correct (i.e. no penalty) since charges would only ramp up to actual usage.</li> <li>• Observes there is a very strong argument within the modifications that these are customer products, whereas the Classes are Shipper settlement products, which may or may not be 'back to backed' with a customer contract. Shippers within the I&amp;C sector with PC 2 sites will, by</li> </ul>



			<p>definition, have access to daily reads and should be able to immediately re-nominate capacity to avoid or minimise ratchet charges and these instances should be fairly infrequent and of a very low magnitudes if the SOQ values have been set realistically. To do this for domestic customers would involve significant resources, both in terms of monitoring, and the potential volumes of sites requiring re-nomination.</p> <ul style="list-style-type: none"> <li>• Commented that in Workgroup discussions SSE proposed the solution of deriving the SOQ from the AQ for smaller customers put into PC 2, as it is currently calculated for smaller customers, and is how it will continue to be calculated for customers in PC 3 and 4. Believed that this would give the best solution of allowing any PC 2 benefits and keeping the SOQ based on AQ, and so avoiding any issues of ratchets and the understating of SOQ values. However, understands that the Nexus systems will be unable to do this at implementation and so any solutions along these lines would have to be developed post Nexus.</li> </ul>
Statoil UK Ltd	<p><b>0571</b> Support</p> <p><b>0571A</b> Oppose</p> <p><b>Prefer</b> <b>0571</b></p>	<p>a - positive d - positive f - positive</p>	<ul style="list-style-type: none"> <li>• Agrees should not be classed as self-governance as both modifications have a material impact on customers.</li> <li>• Supports 0571 as there is a number of small premises that have AQs above 73,200kWhs but that are still subject to the impact of the cold weather on their usage. Believes it would not be advantageous to put these sites in a situation where they could ratchet, thus forcing Shippers to choose PC 3 or 4 and defeating the objective of Nexus to have better control/visibility of the volumes across the industry.</li> </ul>
Wales & West Utilities	<p><b>0571</b> Oppose</p> <p><b>0571A</b> Oppose</p> <p><b>Prefer</b> <b>0571A</b></p>	<p>a - negative d - negative f - negative</p>	<ul style="list-style-type: none"> <li>• Agrees should not be classed as self-governance.</li> <li>• Implementation would not require any additional time over that needed to implement the required changes in UK Link.</li> <li>• Expresses different views regarding the relevant objectives.</li> <li>• Notes that both modifications seek to exempt certain classes from the application of ratchet charges.</li> <li>• <b>0571</b> - Preferred as retains the greater population within the scope of Ratchet Charges. Observes that <b>0571A</b> effectively introduces a division in PC 2, which is effectively a new Class.</li> <li>• <b>Relevant objective (d)</b> - Has sympathy with the argument that ratchets were designed for a constrained system and typically only included very large sites in their scope. The introduction of PC 2 is likely to significantly increase the number of sites classed as Daily Metered, and consequently subject to the risk of Ratchet charges. If a Shipper decides to move a site to PC 2 then they have to accept the responsibility to accurately predict their peak demand requirements and fulfil their obligations of using PC 2 as well as receiving the benefits. Removing any consequence to these sites from understating their needs may not facilitate effective competition between Shippers. This is due to having a potential benefit from understating capacity requirements compared to those Shippers who accurately nominate. Ofgem also reflected on this point in its decision letter for Modification 0551, and a belief that</li> </ul>

			<p>impacts on relevant objective (d) to be negative.</p> <ul style="list-style-type: none"> <li>• Believes the modifications in their current form provide no incentive to book an appropriate level of capacity at peak and could result in unintended consequences. As network charges are levied on peak requirements there is a risk that the chargeable base could decrease as sites knowingly reduce their requirements in the knowledge that should their peak capacity needs materialise to be higher there will be no additional cost. This conversely would require those customers who are not daily metered, currently including small domestic supply points, to pay a larger proportion of network costs.</li> <li>• <b>Relevant objective (f)</b> - Observes that whilst the removal of the Ratchet charge leads to efficiency in billing and reconciling queries relating to these efficiencies, and potential benefits from increasing the volume of daily reads submitted for settlement, it is believed other the factors outlined outweigh any potential benefits and result in a negative impact overall against relevant objective (f).</li> </ul>
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Representations are published alongside the Final Modification Report.

Please note that late submitted representations will not be included or referred to in this Final Modification Report. However, all representations received in response to this consultation (including late submissions) are published in full alongside this Final Modification Report, and will be taken into account when the UNC Modification Panel makes its assessment and recommendation.

## Consultation - Additional Views sought regarding User Pays Arrangements

To inform Ofgem’s subsequent consideration of the User Pays charges described in this proposal, the Panel also asked respondents for their views on who they believe should fund the central implementation costs. This does not form part of Panel’s consideration of these modifications’ suitability for implementation.

## Summary of Views expressed regarding the User Pays Arrangements

Views on the User Pays Arrangements were received from the following parties	
Organisation	Key Points
<b>British Gas Trading</b>	<ul style="list-style-type: none"> <li>• The modifications solution is to suppress Transporter ratchet invoicing for PC 2 customers. This provision exists today, whereby Transporters may suppress the invoicing. Without a formal change to the contract and without agreement to the UNC, Transporters have taken a decision to de-scope this functionality to suppress a ratchet charge post Nexus.</li> <li>• As these modifications only seek to maintain an existing arrangement and the Transporters have made their decision unilaterally the cost of implementing this change must sit 100% with the Transporters.</li> <li>• Put simply – the Transporters have been paid by Shippers to deliver Nexus. They must live with the consequence of their de-scoping decision and ensure the ability to provide a ratchet invoice suppression mechanism is maintained post Nexus.</li> </ul>
<b>Corona Energy</b>	<ul style="list-style-type: none"> <li>• Does not agree that either of these modification proposals will require an automated solution. Currently, a significant proportion of ratchet charges are manually suppressed by Xoserve on behalf of the Transporters and these</li> </ul>

	<p>modifications simply require a change in the criteria for suppressing charges.</p> <ul style="list-style-type: none"> <li>• Were the Transporters to automate this process, there will be a net saving to the industry and so it will be appropriate to credit Shippers for the cost savings.</li> </ul>
<b>E.ON Energy Solutions Ltd</b>	<ul style="list-style-type: none"> <li>• This is an incentive regime that benefits the network companies, by assisting them in ensuring that they are efficiently managing their network. If Ofgem believe that the continuation of the ratchet regime is not appropriate for PC 2 customers, then it would seem incongruous with that decision to penalise the customers to whom the charge no longer applies with the costs of system changes to give effect to that decision, especially given that the decisions on how the regime would operate was taken without any engagement of Users, or with regard to how it operates today.</li> <li>• It would appear that Xoserve and the Transporters have built the system without the ability to exercise discretion on invoicing that they often applied under the current regime. It is likely that the “invoice first and query second process” will lead to more invoices being challenged, resulting in an increase in costs for all parties.</li> </ul>
<b>Gazprom Energy</b>	<ul style="list-style-type: none"> <li>• Both changes simply require that the Transporter’s Agent does not seek to invoice the Shipper for a site that has ratcheted – all other aspects of the ratchet regime are unchanged. The work to not invoice customers when ratchets occur is minor as it is understood that these invoices already have an element of manual intervention; both modifications simply seek to change the reasons for when an invoice is suppressed, not add or remove any processes currently undertaken by Xoserve.</li> <li>• Does not agree that a systemised solution is necessary, but if the Transporters wish to automate the process then would expect an overall cost saving to them and so any form of User Pays adjustment should be a credit to Shippers.</li> </ul>
<b>National Grid Gas Distribution Ltd</b>	<ul style="list-style-type: none"> <li>• These modifications should be considered User Pays and funded by Shipper Users, as they are the principal beneficiaries.</li> <li>• Notes that the proposed changes were not included in the Business Requirement Definitions (BRDs), which established the Project Nexus requirements. Consequently, our view is that as changes to these requirements, the modifications should be considered as User Pays and funded by Shipper Users, who would be the main beneficiaries.</li> </ul>
<b>Northern Gas Networks</b>	<ul style="list-style-type: none"> <li>• Following the FGO review of Xoserve/Central Data Service Provider changes to the central systems should be funded by the constituencies who stand to benefit the most from those changes.</li> </ul>
<b>npower</b>	<ul style="list-style-type: none"> <li>• Does not feel Shippers should cover the costs as the modification(s) applies to efficient management of the network.</li> </ul>
<b>Scotia Gas Networks</b>	<ul style="list-style-type: none"> <li>• The restriction of the ratchets regime is a new requirement and was not identified within the Project Nexus BRDs, and as such should not be funded by the Transporters within the Project Nexus delivery costs.</li> <li>• As Shippers are the only UNC parties whom stand to benefit from this change, considers that central implementation costs should be subject to User Pays arrangements, as per the draft ACS provided at <a href="http://www.gasgovernance.co.uk/0571/241116">http://www.gasgovernance.co.uk/0571/241116</a>.</li> <li>• Notes that given the post-FGO implementation timescales associated with either modification, the new FGO-equivalent User Pays arrangements should be employed.</li> <li>• Both modifications will incur development costs in relation to the central systems, estimated by Xoserve to be in the range of £100k-£300k. There are also likely to be ongoing costs.</li> </ul>

	<ul style="list-style-type: none"> <li>Implementation of either modification is also likely to cause SGN to incur increased costs in respect of network analysis and monitoring, as well as potential reinforcement.</li> </ul>
<b>SSE</b>	<ul style="list-style-type: none"> <li>Believes that the costs should be funded wholly by the Transporters.</li> </ul>
<b>Statoil UK Ltd</b>	<ul style="list-style-type: none"> <li>Believes Shippers should not have to cover the costs because the proposal(s) overall seeks to improve the invoicing processes.</li> </ul>
<b>Wales &amp; West Utilities</b>	<ul style="list-style-type: none"> <li>Ratchet charges seek to ensure that Shippers accurately nominate capacity thus ensuring the most appropriate chargeable base is utilised. Therefore we are of the view that all parties benefit from these arrangements and therefore costs should be jointly met.</li> </ul>

## Summary of Issues raised in responses

To aid understanding, the following summarises the key themes arising from the consultation.

### Potential discrimination between consumers

Respondents recognised the different perceptions and specific concerns that sprang from a party's role as a user/recipient or a manager/executor of the system/regime; there were a number of indirect consequences on parties.

Advances and changes in metering technology also mean that daily read customers will soon include domestic customers and micro-businesses as well as small/medium sized industry and commercial customers, and that there were concerns that the legacy ratchet regime that was designed for large industrial consumers could now have unintended and adverse consequences on parties against which it was never originally envisaged to be applied.

Some respondents observed that introduction of a 'ratchet safe zone' in an attempt to protect domestic customers may be discriminatory towards domestic customers who consume more than 73,200kWh. There are a number of small premises that have AQs above 73,200kWhs but that are still subject to the impact of the cold weather on their usage, and that it may not be advantageous to put these sites in a situation where they could ratchet, thus forcing Shippers to choose PC3 or 4 and defeating an objective of Project Nexus to have better control/visibility of the volumes across the industry.

Some considered that there is no reason why a site that is daily read (PC2) should be exposed to a penal charge regime, when an identical site is not if it is non-daily read (PC3). It was also believed there was also no logic or justification for the discrimination introduced by applying an arbitrary dividing line.

### Accuracy of capacity booking

The ultimate aim for efficient network management is that its users should provide operators with accurate SOQs. It was recognised that the current daily read ratchet charge regime tends to encourage a degree of over-estimation of a customer's predicted peak system needs as shippers and consumers have to err on the side of caution to avoid these penalty charges. Some respondents believed that this could have the effect of creating a sterilization of a certain amount of capacity and an inflated view of peak gas requirements, leading to inefficient investment in potentially unnecessary additional network capacity. However, Transporters countered that this 'disadvantage' or 'shortcoming' has to be balanced against ensuring the safety of the network(s) and the requirement of network owners to maintain security of supply to all users.

Some respondents observed that, in the current operating landscape, where the general picture is that peak demand has declined considerably and that capacity in networks is now virtually unconstrained

(as evidenced by removal of capacity management tools), Transporters have access to other more immediate tools to manage any occurring 'real-time' risk. The application of retrospective charges is not such a tool and this form of control is perceived as not being appropriate in the new settlement regime.

Shippers within the I&C sector with PC 2 sites will, by definition, have access to daily reads and should be able to immediately re-nominate capacity to avoid or minimise ratchet charges and these instances should be fairly infrequent and of a very low magnitude if the SOQ values have been set realistically. However, to do this for domestic customers could involve significant resources, both in terms of monitoring and the potential volumes of sites requiring re-nomination.

Some respondents felt that the modifications, in their current form, provide no incentive to book an appropriate level of capacity at peak and could result in unintended consequences. As network charges are levied on peak requirements there is a risk that the chargeable base could decrease as sites knowingly reduce their requirements in the knowledge that should their peak capacity needs materialise to be higher than anticipated, there will be no additional penal cost. This conversely would require those customers who are not daily metered, currently including small domestic supply points, to pay a larger proportion of network costs.

### **Ability to control the risk of overruns**

Concerns were raised regarding the potential impacts on (larger) domestic consumers, who are not used to predicting capacity use. Such consumers would never expect to have the same detrimental impact on the network by exceeding their capacity that a large user may have, and would have no experience of determining their capacity needs. Neither is it clear that a consumer or their supplier can elect which settlement class the Shipper may use and therefore a customer may not be able to control/avoid the risk of overrun.

One respondent noted that these proposals make a direct link to consumers, whereas the Product Classes are Shipper settlement products, which may or may not be reflected in a customer contract.

### **Realising the benefits of the new settlement regime**

A number of views were expressed regarding the potential benefits in respect of the ability to embrace the opportunities to achieve more accurate cost allocation and a reduction in settlement risk. Some indicated that a substantial portion of these benefits can only occur/be realised if there are no penal barriers to customers becoming daily settled, allowing the increased granularity of site consumption to flow through to settlement, which would improve cost allocation and reduce settlement risk. The more consumption that is settled under PC 1 and PC 2 the greater the reduction in volatility associated with the smearing factors, which are used to manage unallocated consumption. This increased certainty would aid more accurate cost allocation and reduce risk premiums in the market.

### **Safety of networks**

Transporter respondents provided views relating to system integrity and their obligations to protect gas consumers. It was noted that although the long-term trend for the consumption of gas is downward, Peak Day demands can, and do, increase from year to year.

Gas Transporters observed that Standard Licence Condition A16 necessitated, and Ofgem's decision letter for UNC Modification 0551 noted, that the existing methodology (for satisfying this licence condition) has been developed and applied on the basis of the ratchets regime being in place to its full extent, and that restriction of the ratchet regime is likely to result in a significant change in network management methodology being taken going forwards.

Having the ability to access/use every available and appropriate tool to assist in maintaining the safety and stability of the networks was highlighted. The more specific concerns in respect of particular

networks with different profiles, where there may be an intrinsic link between SOQs and network capacity, with the former providing effective market signals to inform the latter. It was noted that this market signal is especially important on single-fed lines such as those commonly seen on the Scottish distribution network.

There had been recent recourse to the ratchet regime and ratchet charges had been applied in the winter of 2015/16; this may indicate that accurate management of SOQs persists as a difficulty for many users and the effects/consequences of removal/change to any aspect may require greater consideration. Real-time monitoring does not replace 'good' behaviour and that such monitoring, whilst helping to swiftly identify an issue, will not prevent an on-the-day supply emergency caused by capacity being over-utilised on a constrained part of the network. The ratchets regime is deemed to be the only incentive currently in place to discourage inaccurate management of SOQs. An unexpected increase in consumption by one consumer within a constrained area would have significant implications on the security of supply for surrounding consumers and would also have significant impacts upon the consequent safety of the network.

The latter was seen by Transporters to be of primary importance and there was a belief that any restriction of the ratchets regime would have an indirect impact on at least one of the Transporters' Safety Cases. A formal statement was received from SGN (published alongside this report) that confirmed their view of there being an indirect impact on their Safety Case.

Transporters believe that the current ratchets regime positively incentivises nomination of realistic peak-day demands, and that this is important to efficiently manage the physical system and for carrying out future demand estimation activities. It was also noted that Transporters' systems continue to operate with physical constraints in some geographic areas, which requires active management.

### Looking further ahead

The following suggestions were made, that might usefully be taken forward by industry parties:

- the new settlement regime delivered by Project Nexus should be subject to a bedding-in period to establish some reliable performance trends, before an assessment of the success or otherwise of the Classes, and therefore amendments to their design, are made.
- the proposal of a further alternative solution, deriving the SOQ from the AQ for smaller consumers put into PC 2, which may be pursued post Nexus.
- Monitoring of capacity overbooking could be undertaken by the Performance Assurance Committee.

## 9 Panel Discussions

### Panel Deferral of further Consideration

At its meeting on 16 February 2017, Panel considered the safety impacts highlighted by SGN. Ofgem advised that it was their policy to require that the HSE had been engaged where there were such matters to ensure that any regulatory decision they were required to make did not adversely impact safety. Members considered that there were no further matters that Panel could reasonably expect a Workgroup to assess; it was for SGN, and any other transporter with concerns, to engage the HSE in respect of their Safety Case.

To ensure that there wasn't undue delay, Panel agreed to defer further consideration of this report for three months.

Following further discussion at its meeting on 16 March 2017, Panel determined that there were new issues related to potential gaming issues identified in consultation responses and that these issues required further consideration by Workgroup.

## 10 Recommendations

### Panel Recommendations

Members recommended:

- that Modification **0571** was [not] suitable for implementation.
- that Modification **0571A** was [not] suitable for implementation.
- that Modification **0571 0571A** better facilitates the relevant objectives than Modification **0571 0571A**.



# 11 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

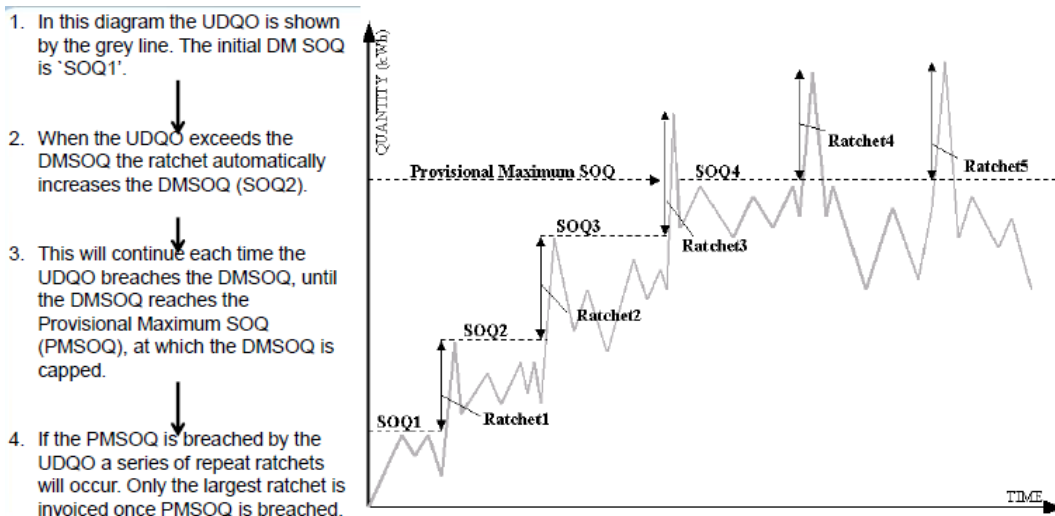
When a Shipper takes ownership of a supply point they must nominate a Daily Supply Point Offtake Quantity (SOQ), which must not be less than the Bottom Stop SOQ (BSSOQ), the maximum daily amount off-taken in the previous winter period. Should the User Daily Quantity Off-Take (UDQO) exceed the booked 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



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

## 12 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.

## 13 Appendix 3 - Analysis of Sites eligible for Ratchets

The following information was provided by Xoserve in response to actions requested by the Workgroup.  
*Note:* this information is correct as of 19<sup>th</sup> June 2016.

*June Action 0501: Xoserve (SN) to investigate the number of Domestic LSP's are above the limit of 73,200kWhs.*

**Response:** The number of Market Sector Flags (MSF) set as domestic on sites with an AQ greater than 73,200kWhs is 30,882.

There are currently 2 DM sites which have the MSF set as Domestic.

*June Action 0502: Xoserve (SN) to supply data on the number of mandatory DM and DMV sites.*

**Response:** Current total DM sites = 1121, of this 799 are DMV sites. This can change on a daily basis.

### **Additional information:**

Number of Ratchets invoiced on DM Supply points in the winter of 2015/16:

Year	Month	Number of Ratchets
2015	October	18
2015	November	29
2015	December	20
2016	January	39
2016	February	30
2016	March	23
2016	April	13
TOTAL		172

Please note the ratchets were applicable for 90 sites throughout this period, several sites had multiple ratchets.

*July Action 0604: To provide a breakdown of ratchets across Class 1 and 2 sites.*

**Response:** For action 0604 Xoserve were asked to break this down into DM Voluntary and DM sites, the table below shows this breakdown:

<b>DM Type</b>	<b>Count</b>
DM Sites	25
DM Voluntary	65
<b>Grand Total</b>	<b>90</b>