

Stage 01: Proposal

0382:

Reducing the capacity element of LDZ system charges for SSPs

What stage is this document in the process?

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

LDZ system charges are weighted 95:5 between capacity and commodity. This modification seeks to amend this to 50:50 for SSPs.



The Proposer recommends that this Transportation Charging Methodology modification should be issued to consultation



High Impact: Smaller Shippers

Cashflow impact, aligning costs and revenues



Medium Impact:

Insert name(s) of impact



Low Impact: Transporters

Cashflow impact

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About this document:

This document is a proposal, which will be presented by the Proposer to the Panel on 19 May 2011. The Panel will consider the Proposer's recommendation, and agree whether this modification should be issued to consultation or be referred to a Workgroup for assessment.



3 Any questions?

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1 Summary

Is this a Self-Governance Modification

Implementation would have a significant impact on smaller domestic suppliers in particular, and so does not meet the criteria for a self-governance modification.

Why Change?

The present LDZ charging arrangement is primarily based on capacity bookings, which are largely fixed throughout the year. Supplier revenue is driven by the amount of gas consumed, which is higher in winter than in summer. This creates a mismatch between supplier costs and revenues, and potentially makes the sale of gas a loss making activity during the summer months. This creates cashflow issues and is a barrier to entry.

Solution

It is proposed that, for Smaller Supply Points, the capacity element of the LDZ System charges be targeted to recover 50% rather than 95%, and the commodity element of the LDZ System charges is targeted to recover 50% rather than 5%, of the revenue from the LDZ system charges.

Impacts & Costs

Since the Transporters introduced a move to charging based on a 95:5 rather than 50:50, no significant systems impacts are anticipated if this is reversed. The Transporters funded all systems costs associated with the move to 95:5 and would similarly be expected to fund any costs which arise from a return to 50:50.

Implementation

This modification should be implemented at the earliest possible opportunity.

The Case for Change

Implementation will facilitate competition by helping to ensure revenue and costs are more closely aligned, reducing the possibility of gas being supplied at a loss during the summer months and addressing a cashflow issue which can act as a barrier to entry and a barrier to business development for smaller suppliers in particular.

Recommendations

It is recommended that this modification should proceed directly to consultation.

2 Why Change?

The present LDZ charging arrangement is primarily based on capacity bookings, which are largely fixed throughout the year. In the case of domestic suppliers, transportation charges are based on AQs which are set for a year and do not always reflect the true level of capacity usage, especially when energy efficiency measures are installed, reducing consumption without any immediate benefit through reduced capacity charges. By contrast, Supplier revenue is driven by the amount of gas consumed, which is higher in winter than in summer, and is reduced as a result of energy efficiency initiatives.

The mismatch between the profiles of supplier revenue and transportation charges potentially makes the sale of gas a loss making activity during the summer months. While this may not create particular difficulties for suppliers with large, diverse portfolios, or those with a low cost of capital, a significant cashflow issue is created for some suppliers. The issue is particularly acute for smaller suppliers with a primarily domestic customer base, and especially those that actively promote and encourage adoption of energy efficiency measures. The mismatch therefore creates an inappropriate barrier to market entry and business development, and change is needed to encourage greater competition within the domestic market.

3 Solution

It is proposed that, for Smaller Supply Points, the DN Transportation Charging methodology, as set out in Section Y of the UNC, is modified such that the capacity element of the LDZ System charges be targeted to recover 50% rather than 95%, and the commodity element of the LDZ System charges is targeted to recover 50% rather than 5%, of the revenue from the LDZ system charges.

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4 Relevant Objectives

The Proposer believes that implementation will better facilitate the achievement of

Relevant Methodology Objective a and c.

Proposer's view of the benefits against the Code Relevant Methodology Objectives

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

Cost reflectivity would be improved (Relevant Objective a) since capacity related costs are driven by peak demands, which arise in the winter. It is therefore more cost reflective for the collection of charges to be focussed on the winter months, when peak demand is more likely to arise.

Competition would be facilitated (Relevant Objective c) by more closely aligning the profile of revenues and costs. This would remove the barrier to entry that smaller suppliers, in particular, face at present because of the mismatch between costs and revenues. This creates a cashflow problem, with cashflow being widely recognised as a major issue for smaller organisations and new entrants. The present arrangements can make supply to domestic premises loss making in the summer months, which is a strong deterrent to entry and customer acquisition prior during the summer months. Creating more appropriate incentives to acquire customers, to encourage energy efficiency, and to remove barriers to entry would facilitate the development of effective competition.

The modification does not conflict with paragraphs 2, 2A and 3 of Standard Special

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Condition A4 of the Transporter's Licence since any change in charges would be applied based on the methodology prevailing at the time.

5 Impacts and Costs

Costs

Indicative industry costs – User Pays	
Classification of the proposal as User Pays or not and justification for classification	
Transporters would need to ensure invoice calculations reflect their obligations. This is a Transporter responsibility and therefore this is not a User Pays modification. The basis for funding should be the same as that when Transporters introduced a 95:5 capacity:commodity split, with the transporters funding any costs faced by themselves.	
Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification	
Not applicable	
Proposed charge(s) for application of Users Pays charges to Shippers	
Not applicable	
Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from xoserve	
Not applicable	

Impacts

Impact on Transporters' Systems and Process	
Transporters' System/Process	Potential impact
UK Link	• None
Operational Processes	• None
User Pays implications	• None

Impact on Users	
Area of Users' business	Potential impact
Administrative and operational	• None
Development, capital and operating costs	• Costs re-profiled
Contractual risks	• None

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Where can I find details of the UNC Standards of Service?

In the Revised FMR for Transco's Network Code Modification

0565 Transco Proposal for Revision of Network Code Standards of Service

at the following location:

<http://www.gasgovernance.co.uk/sites/default/files/0565.zip>

Impact on Users	
Legislative, regulatory and contractual obligations and relationships	<ul style="list-style-type: none"> None

Impact on Transporters	
Area of Transporters' business	Potential impact
System operation	<ul style="list-style-type: none"> None
Development, capital and operating costs	<ul style="list-style-type: none"> None anticipated
Recovery of costs	<ul style="list-style-type: none"> Re-profiling would occur
Price regulation	<ul style="list-style-type: none"> The Charging methodology would be modified
Contractual risks	<ul style="list-style-type: none"> None
Legislative, regulatory and contractual obligations and relationships	<ul style="list-style-type: none"> None
Standards of service	<ul style="list-style-type: none"> None

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

Impact on Code	
Code section	Potential impact
Section Y	Replace "95" and "5" with 50

Impact on UNC Related Documents and Other Referenced Documents	
Related Document	Potential impact
Network Entry Agreement (TPD I1.3)	None
Network Exit Agreement (Including Connected System Exit Points) (TPD J1.5.4)	None
Storage Connection Agreement (TPD R1.3.1)	None

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Impact on UNC Related Documents and Other Referenced Documents	
UK Link Manual (TPD U1.4)	None
Network Code Operations Reporting Manual (TPD V12)	None
Network Code Validation Rules (TPD V12)	None
ECQ Methodology (TPD V12)	None
Measurement Error Notification Guidelines (TPD V12)	None
Energy Balancing Credit Rules (TPD X2.1)	None
Uniform Network Code Standards of Service (Various)	None

Impact on Core Industry Documents and other documents	
Document	Potential impact
Safety Case or other document under Gas Safety (Management) Regulations	None
Gas Transporter Licence	None

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

6 Implementation

The modification should be implemented as soon as possible, such that the revised charging basis would apply when transportation charges are subsequently amended.

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7 The Case for Change

None in addition to that identified above.

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8 Legal Text

Suggested Text

Amend section 3 of UNC TPD Section Y, PART B – DN TRANSPORTATION CHARGING METHODOLOGY, The Gas Distribution Transportation Charging Methodology to read as follows:

3. Split of revenue recovery between LDZ System Capacity and Commodity Charges

For Smaller Supply Points, the capacity element of the LDZ System charges is targeted to recover 50%, and the commodity element of the LDZ System charges is targeted to recover 50%, of the revenue from the LDZ system charges. This split is based on an assessment of the extent to which LDZ System associated costs are related to throughput or to system capacity. The 50:50 split applies to all the DNs.

For Larger Supply Points, the capacity element of the LDZ System charges is targeted to recover 95%, and the commodity element of the LDZ System charges is targeted to recover 5%, of the revenue from the LDZ system charges. This split is based on an assessment of the extent to which LDZ System associated costs are related to throughput or to system capacity. The 95:5 split applies to all the DNs.

9 Recommendation

The Proposer invites the Panel to:

- DETERMINE that Modification 0382 progresses to Consultation

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