





0571A:








Application of Ratchets Charges to Class 1 Supply Points and Class 2 with an AQ above 73,200kWhs

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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, this modification limits the application of Ratchets Charges to Class 2 Supply Points with an AQ above 73,200 kWhs.

	The Proposer recommends that this modification should: <ul style="list-style-type: none"> not be subject to self-governance; and should be assessed by a Workgroup
	High Impact: Shipper Users and Transporters
	Medium Impact: None
	Low Impact: None

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About this document:

This modification is to be presented by the proposer to the panel on 19 May 2016.

The panel will consider the proposer’s recommendation and agree whether this modification should be:

- Issued to workgroup for assessment.

The Proposer recommends the following timetable:

Initial consideration by Workgroup	26 May 2016
Workgroup Report presented to Panel	16 June 2016
Draft Modification Report issued for consultation	16 June 2016
Consultation Close-out for representations	08 July 2016
Final Modification Report presented to Panel	11 July 2016
UNC Modification Panel decision	21 July 2016

1 Summary

Is this a Self-Governance Modification?

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

Is this a Fast Track Self-Governance Modification?

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

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. Shippers will be able to choose a settlement classes that offers the equivalent of daily metered arrangements where they have a suitable meter that collects daily metering data, but the customer could have a very low network demand. With the exception of customers that are obligated to be in Settlement Class 1, Shippers can elect customers into any settlement class under the new arrangements, providing that they have suitable metering equipment to satisfy the read requirements of the class.

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 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

Our proposed solution is that Ratchets Charges should only apply to Class 1 and Class 2 Supply Points with an annual AQ that exceeds 73,200 kWhs.

Relevant Objectives

We believe this modification enhances competition between Shippers because it ensures that the behaviour ratchets charges incentivise is targeted only at larger consumers who expect to more actively manage their demand whilst removing a potential disincentive for the broader utilisation of Class 2.

Implementation

No implementation timescales are proposed. However we would expect this modification to be implemented in line with Project Nexus Go Live if practicable.

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

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

2 Why Change?

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 opting into DM arrangements and they are then subject to the same rights and restrictions as other DM customers; 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.

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. Shippers will be able to choose a settlement classes that offers the equivalent of daily metered arrangements where they have a suitable meter that collects daily metering data, but the customer could have a very low network demand. With the exception of customers that are obligated to be in Settlement Class 1, Shippers can elect customers into any settlement class under the new arrangements, providing that they have suitable metering equipment to satisfy the read requirements of the class.

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.

We believe 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, that they would have their capacity determined for them based on their consumption, and they would benefit from individual meter point reconciliation, irrespective of their designation as a SSP or LSP NDM supply point.

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 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 where ratchet charges don't apply; 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 Ratchets¹, Ofgem recognised the importance of ratchets in incentivising Shippers to accurately determine the supply point capacity and the relationship to accurate transportation charges.

[This modification 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.](#)

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

The original proposal argues that the primary reason for customers being treated as DM is to ensure the integrity of settlement, however whilst a threshold of 2m therms does require a customer to operate as DM, the difference between the treatment of a customer as DM is not limited to just the submission of meter readings, and of course the networks can designate smaller sites to be required to be DM Mandatory – not because of their ability to submit daily meter readings, or for the integrity of settlement, but because of their physical impact on the performance of the network, and to protect the continuity of supply to large numbers of smaller premises.

The treatment of product class under the new rules not only preserves the DM requirements, but it continues to facilitate a regime where customers can elect into the same elective DM regime as today, Product Class 2 offers that option and 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.

In choosing the threshold of 73,200 KWhs rather than a supply class, I have relied on the treatment of site capacity in other legislation as an appropriate measure for grouping customers and applying specific rules to that group. This threshold of 73,200 KWhs applies in statute already – the Gas Calculation of Thermal Energy Regulations 1996 treats customers above and below this threshold differently – those below the threshold have general principles applied, where those above this threshold have site specific treatment applied. Equally Ofgem and government departments regularly treat this as the threshold definition of a domestic customer/premise, in the reports they publish on consumption.

It is fair to say that individual SSP customers (whether domestic or non-domestic) are unlikely to have a detrimental impact on the operation of the network – even during an unexpected cold snap, but larger customers who are in Class 2 could still have a load that doesn't meet the DM Mandatory threshold of Class 1, yet could have impacts on the operation of the network at times of peak demand if they exceed their booked capacity and for that reason, it is important that the networks have the appropriate incentives to ensure that capacity is accurately forecasted and booked. It seems entirely reasonable therefore to not apply the ratchet charges to a small supply point customer whose demand is temporarily affected by an unforeseeable event whilst at the same time protecting the network from the potential risk posed by larger customers.

3 Solution

Our proposed solution is that Ratchets Charges should be limited to Class 1 and Class 2 Supply Points only 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.	This is a proposed amendment to an existing ratchet incentive regime as it is proposed to restrict Ratchets Charges to Class 1 & 2 supply points with an AQ which exceeds 73,200 kWhs. No new User Pays service is being created.
Identification of Users of the service, the proposed split of the recovery between Gas Transporters and Users for User Pays costs and the justification for such view.	All Users with Supply Points other than Class 1 could benefit from the potential to easier access Class 2 arrangements and costs would be recharged on the basis of eligible Supply Points

Proposed charge(s) for application of User Pays charges to Shippers.	<i>To be confirmed</i>
Proposed charge for inclusion in the Agency Charging Statement (ACS) – to be completed upon receipt of a cost estimate from Xoserve.	<i>To be confirmed</i>

4 Relevant Objectives

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

We believe this modification ensures that the behaviour Ratchets Charge incentivise apply only to the largest 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, which as Advanced and Smart metering rollout continues will become available to more consumers with lower levels of consumption, therefore it is securing effective completion between Shipper Users and furthering Relevant Objective d).

5 Implementation

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

6 Impacts

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

This modification impacts Project Nexus but only in a very limited way as it removes the applicability of Ratchets Charges from Class 2 Small Supply Points.

7 Legal Text

To be provided by Transporters.

8 Recommendation

The Proposer invites the Panel to:

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

Appendix 1 – Ratchet Charges

What is a Ratchet?

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

Current Process Overview

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

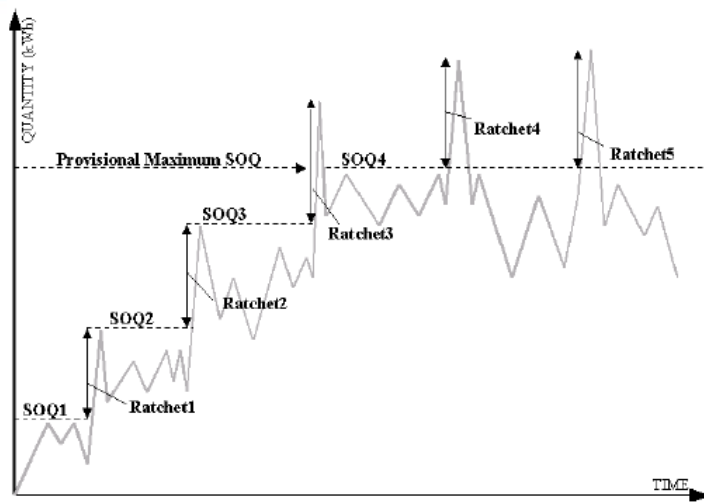
Ratchets are applicable to Daily Metered Supply Points, or the Daily Metered component within a mixed Supply Point.

Ratchet Calculation

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

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

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



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