













# 0571A:

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

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 AQt, 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"> <li>• not be subject to self-governance; and</li> <li>• should be assessed by a Workgroup</li> </ul>
	High Impact: Shipper Users and Transporters
	Medium Impact: None
	Low Impact: None

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This modification was presented by the Proposer to the Panel on 19 May 2016.		 01926 653541
The Panel considered the Proposer’s recommendation and agreed this modification should be:		Systems Provider: <b>Xoserve</b>
<ul style="list-style-type: none"> <li>Issued to Workgroup for assessment.</li> </ul>		 <a href="mailto:commercial.enquiries@xoserve.com">commercial.enquiries@xoserve.com</a>
The Proposer recommended 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 [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

Our proposed solution is 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

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~~ 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.

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 the ~~key~~ key ~~have~~ is ~~a~~ is ~~suitable~~ is ~~meter~~ is ~~installed~~ is ~~that~~ is ~~collects~~ is ~~daily~~ is ~~metering~~ is ~~data~~ is ~~;~~ is ~~but~~ is ~~the~~ is ~~customer~~ is ~~could~~ is ~~have~~ is ~~a~~ is ~~very~~ is ~~low~~ is ~~network~~ is ~~gas~~ is ~~demand~~ is ~~.~~ is ~~With~~ is ~~the~~ is ~~exception~~ is ~~of~~ is ~~customers~~ is ~~that~~ is ~~are~~ is ~~obligated~~ is ~~to~~ is ~~be~~ is ~~in~~ is ~~Settlement~~ is ~~Class~~ is ~~1,~~ is ~~Shippers~~ is ~~can~~ is ~~elect~~ is ~~customers~~ is ~~into~~ is ~~any~~ is ~~settlement~~ is ~~class~~ is ~~under~~ is ~~the~~ is ~~new~~ is ~~arrangements,~~ is ~~providing~~ is ~~that~~ is ~~they~~ is ~~have~~ is ~~suitable~~ is ~~metering~~ is ~~equipment~~ is ~~to~~ is ~~satisfy~~ is ~~the~~ is ~~read~~ is ~~requirements~~ is ~~of~~ is ~~the~~ is ~~class.~~ is

Customers who are elected into Settlement Class 2 by their Shipper will have to operate within the requirements of the 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 with individual meter point reconciliation, but that they would have their capacity determined – derived from for them based on their consumption information, 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, 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 because 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.

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.

The original proposal argues that the primary reason for customers being treated as DM is to ensure the integrity of settlement, this is not the case. 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. ~~h~~

~~However whilst a threshold of 2m therms does require a customer to operate as DM, 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 difference between the treatment of a customer as DM is not limited to just the submission of meter readings, The DN's 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. 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.~~

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.

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

The treatment of product class under the new rules ~~not only~~ preserves the existing DM mandatory requirements (using Product Class 1); ~~but #Product Class 2~~ continues to facilitate a regime where customers can elect into the same elective DM regime as today, ~~Product Class 2 offers that option and 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.

~~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.~~ 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.

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

- We split customers 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 annually (NDM SSPs).
- We treat the management of AQs differently, depending on whether they fall above or below a threshold, today you can appeal an NDM LSP site's AQ at any point in the year, however a domestic level NDM SSP site with an AQ below 73,200 KWhs can only be revised during the Annual AQ 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.

So in terms of this modification, in determining a threshold of 73,200 KWhs rather than a supply class, I have relied 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, which I believe is preferable to 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.

~~-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 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

Our proposed solution is that Ratchets Charges should be limited ~~to~~ to all Class 1 Supply Points and to Class 2 Supply Points only with an AQ which exceeds 73,200 ~~kWhs~~ 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.	<del>To be confirmed</del> We propose as this relates to the operation of incentive that protect the network operator from inefficient operation of the network that the charges to suppress 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.
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.	<del>None</del> Positive
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 the modification better targets the incentive regime that is operated by the network operator to mitigate their capacity risks, and therefore facilitates Relevant Objective a)



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

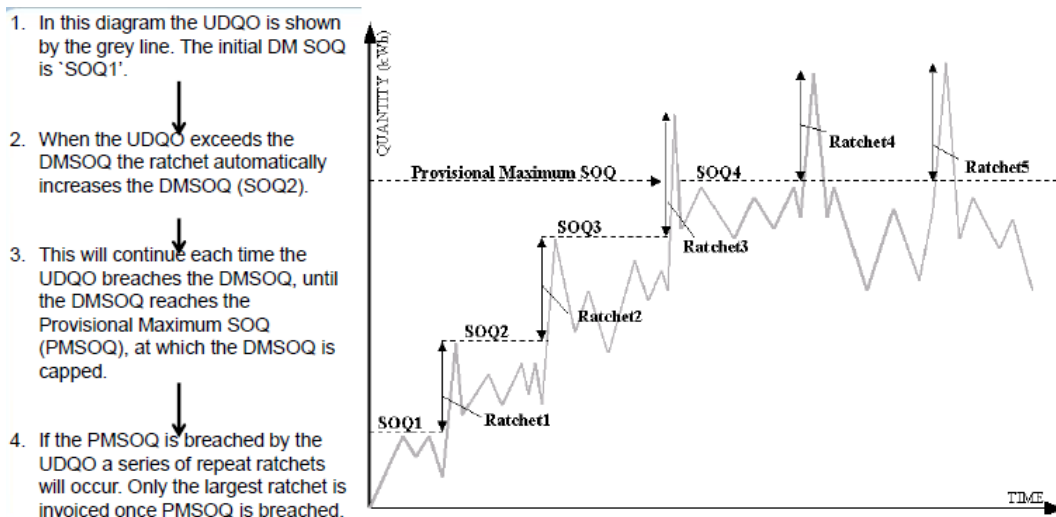
increasing the SOQ to the new peak off-take, subject to the provisional maximum SOQ for the Supply Point.

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