Stage 02: Workgroup Report	At what stage is this document in the process?

0571 0571A:

Application of Ratchets Charges to Class 1 Supply Points Only

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

	The Workgroup recommends that this modification should now proceed to consultation.
	High Impact: Shipper Users and Transporters
	Medium Impact: None
	Low Impact: None

Contents

About this document:

This report will be presented to the panel on 16 June 2016.

The panel will consider whether the modification should proceed to consultation or be returned to the workgroup for further assessment.

The Proposer recommends the following timetable:	
Initial consideration by Workgroup	28 January 2016
Amended modification considered by Workgroup	28 April 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

Any questions?

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1 Summary

Is this a Self-Governance Modification?

These are not considered to be a Self-Governance modifications, because they are 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. 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 capacity because they are exposed to an unforeseen weather event that sees them temporarily increase their heating load.

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

Modifications 0571 and 0571A enhances competition between Shippers because it ensures that the behaviour ratchets charges incentivises is targeted only at larger consumers (relevant Class 1 Supply Points for 0571 and Class 1 and larger Class 2 Supply Points for 0571A), whilst removing a potential disincentive for the broader utilisation of Class 2.

Implementation

No implementation timescales are proposed.

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

These modifications potentially impact Project Nexus but only in a very limited way as they remove the applicability of Ratchets charges from Class 2 Supply Points for 0571 and Class 2 Supply Points with an AQ less than or equal to 73,200kWh for 0571A.

2 Why Change?

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

The market is at the threshold of major change with a number of significant projects coming into effect as well as new initiates 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 minute data.

When considering the proposed arrangements for market operation post Nexus Go Live the relevance of the application of Ratchet Charges in Class 2 seems disproportionate considering the potential utilisation of this class by a wide range of customers, including domestic customers, other than traditional DM customer's i.e. very large industrial process customers. These potential future Class 2 customers do not materially impact the operation of the Network and thus no justification exists 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.

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. We believe 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. We therefore propose to limit Ratchet Charges to Class 1,).

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.

Some consider 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 Ratchets[1], Ofgem recognised the importance of ratchets in incentivising Shippers to accurately determine the supply point capacity and the relationship to accurate transportation charges.

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

Having considered the options within the workgroup (see paper attached as Annex 2) on how to best achieve this goal we believe 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 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.	No new User Pays service is being amended or created by these modifications.

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

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.	*Not applicable*
Proposed charge(s) for application of User Pays charges to Shippers.	*Not applicable*
Proposed charge for inclusion in the Agency Charging Statement (ACS) – to be completed upon receipt of a cost estimate from Xoserve.	*Not applicable*

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

Modification 0571
This modification ensures that the behaviour Ratchets 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).

Modification 0571A
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 (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

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

These modifications potentially impact Project Nexus but only in a very limited way as they propose to remove the applicability of Ratchets Charges from all or some categories of Class 2 Supply Points. It should be noted that Class 3 or 4 consumers who transfer to Class 2 are automatically afforded protection from Ratchet charges for the 1st year and so implementation could delayed until after Nexus Go Live.

7 Legal Text

Text Commentary

0571

Notes
1. The table is based on the legal drafting for Modification 0571 submitted by NGG 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
AMENDMENT TO TPD Section B: System Use and Capacity	
Amended paragraph	Includes additional wording to clarify that the Supply Point

4.7.1	Ratchet Charge will apply to ‘a Class 1 Supply Point’ only.

0571A

Notes

1. The table is based on the legal drafting for Modification 0571 submitted by NGG 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 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 0571 will modify TPD Section B (System Use & Capacity).

Paragraph	Explanation
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 73,200KwH’ only.

Text

The following Text has been prepared by National Grid Distribution and no issues were raised by the Workgroup regarding its content.

Text 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 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 Recommendation

The Workgroup invites the Panel to:

- Determine that these modifications should not be issued to consultation.

9 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.

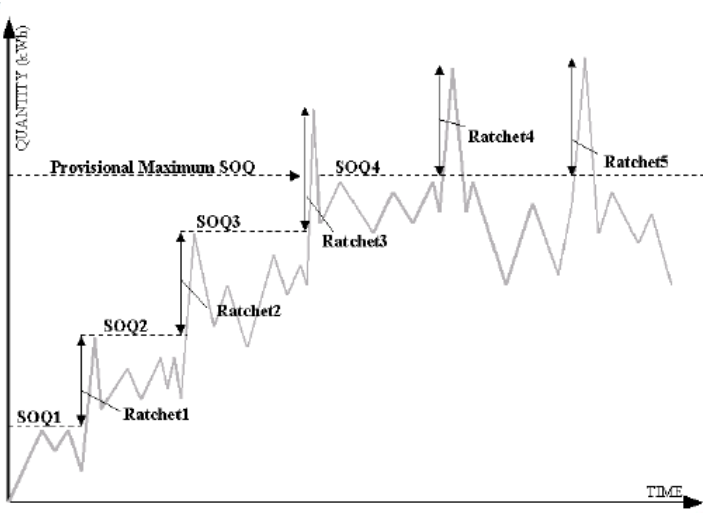
Ratchets are applicable to Daily Metered Supply Points, or the Daily Metered component within a mixed Supply Point.

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

10 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	1. Approach is consistent with methodology used elsewhere 2. Simple 3. Concept of minimum SOQ has existed before	1. System changes may be needed to facilitate
2. Apply Ratchets without penalties	1. As MPRN's are daily read the correction would occur dynamically (little lag) 2. Simple	1. No penalties
3. Apply Ratchets with sliding penalties	1. Targets penalties	1. Proportionally risk is same for all customers 2. Will need to determine ranges for penalties

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.