

# 0571 0571A:

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



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 proceed to consultation
	High Impact: Shipper Users and Transporters
	Medium Impact: None
	Low Impact: None

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<b>About this document:</b>		
This report will be presented to the panel on 15 December 2016.		
The panel will consider whether the modification should proceed to consultation or be returned to the workgroup for further assessment.		
The Workgroup recommends the following timetable:		
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	10 January 2017	
Final Modification Report presented to Panel	12 January 2017	
UNC Modification Panel decision	19 January 2017	
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# 1 Summary

## Is this a Self-Governance Modification?

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 Panels 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 to 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.

## 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 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.

## Does this modification 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. 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.

### **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	
<p>Classification of the modification as User Pays, or not, and the justification for such classification.</p>	<p>0571 and 0571A – 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 (0571A). 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 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>
<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>	<p>Some participants consider 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 have 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 <a href="#">Positive 0571A</a>
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 <a href="#">0571A</a>
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 <a href="#">0571A</a>
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 participants consider 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 participants consider 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 participants consider Modification 0571 could impact the Transporters 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 transporters ability to manage its network efficiently, therefore impacting relevant objective a) Efficient and economic operation of the pipe-line system.

### **Modification 0571A**

Some participants consider 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

### Does this modification 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.

## 7 Legal Text

### Text Commentary

#### 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.

### Text

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

### Text 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 ~~(+)~~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 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 ~~(†)~~ 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:

- Agree that these modifications should be issued to consultation;
- Request respondents to provide views on the User Pays status of these modifications.

## 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

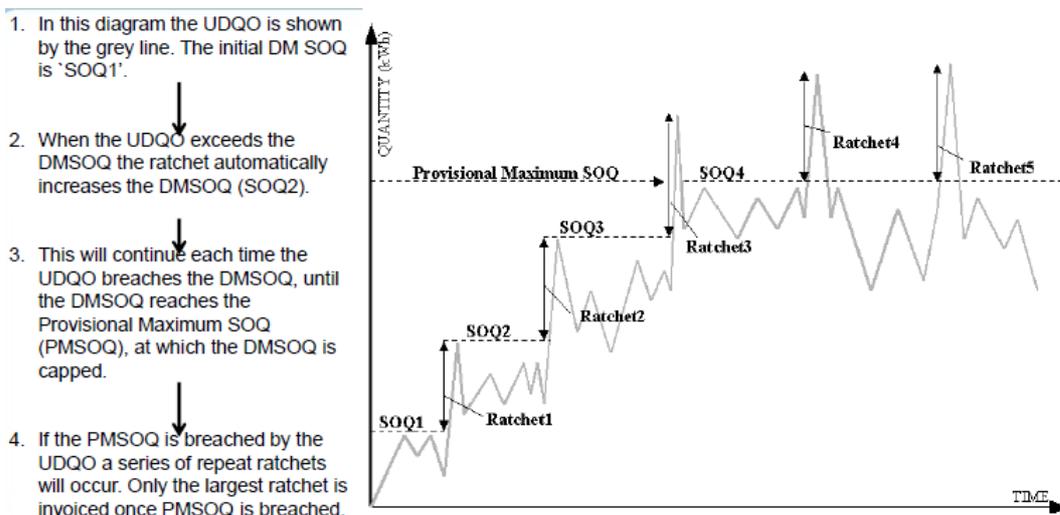
When a Shipper takes ownership of a supply point they must nominate a Daily Supply Point Offtake Quantity (SOQ), which must not be less than the Bottom Stop SOQ (BSSOQ), the maximum daily amount off-taken in the previous winter period. Should the User Daily Quantity Off-Take (UDQO) exceed the booked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



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	<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.

## 11 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
<b>TOTAL</b>		<b>172</b>

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:

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