

Modification proposal:	Uniform Network Code (UNC) 665: Changes to [the] ratchet regime (UNC665)		
Decision:	The Authority ¹ directs this modification be made ²		
Target audience:	UNC Panel, Parties to the UNC and other interested parties		
Date of publication:	29 March 2019	Implementation date:	1 October 2019

Background

Much of the cost to a Gas Shipper (shipper) for use of a Gas Transporter's (GT) network is made up of a capacity charge. In the case of Non-Daily Metered (NDM) supply points, the capacity charge is calculated by the GT using a combination of the relevant Annual Quantity (AQ), which is derived from submitted meter reads, and the End User Category (EUC) of the supply point. This calculation provides the Supply Point Capacity (SPC).³ For Daily Metered (DM) sites the SPC is nominated by the relevant shipper rather than calculated by the GT.

Whilst shippers have an incentive to ensure that the SPC is no greater than necessary, the GTs also rely on these values being accurate in order to ensure that sufficient capacity is available to those sites to safely meet demand in peak flow conditions. The transportation charges therefore include provision for a liability charge, aimed at deterring shippers from setting a SPC below peak winter demand. This liability forms part of the Ratchet Charging Arrangements, so called as the SPC is incrementally increased to a new value if the prevailing capacity nomination is breached. The accuracy of SPC is therefore an important system management tool, and may indicate whether and where pipeline reinforcement may be necessary in order to increase capacity to meet demand.

Until recently it was only economically viable for larger sites to be DM as this required the installation of data-loggers and daily read equipment⁴ provided by the GT. There was therefore a correlation between the meter read frequency at the site and its importance to the safe and economic operation of the network. However, since the introduction of revised network interruption arrangements⁵, the population of non-mandatory DM sites has reduced, despite the roll out of smart meters and Automatic Meter Reading (AMR). The link between a supply point's read frequency and its risk to the network was arguably removed with the implementation of Project Nexus in June 2017. Part of the Project Nexus business requirements were to enable any supply point for which the reads are available to be classified as DM and subject to the same gas allocation and settlement rules as larger DM supply points, if the relevant shipper so chooses. These non-mandatory DM supply points are referred to as being in settlement product 'Class 2', whereas the mandatory DM supply points are in 'Class 1'.

The potential exposure to ratchet liabilities has been identified as a deterrent to shippers re-classifying their sites as DM, even where the necessary metering equipment is in

¹ References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.

² This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

³ Supply Point Capacity (SPC) is the daily capacity at a Supply Point which the shipper is treated as utilising – it effectively signals the maximum daily offtake in the year.

⁴ The UNC requires any supply point with an AQ above 58,600,000 kWh to be DM, and that the meter readings will be procured by the relevant GT.

⁵ See: UNC090: [Revised DN Interruption Arrangements](#)

place. As a consequence, even larger supply points remain in the NDM settlement categories, reliant upon profile based estimates for gas allocation and prolonging the period before they are accurately reconciled. This is considered to be a significant contributor to the volumes and volatility of unidentified gas (UIG). Given its volatility, the cost of UIG to suppliers varies greatly, but for the purposes of the tariff cap we have made an allowance for it to be 2% of wholesale gas costs, potentially adding around £100m to domestic consumers' bills. Those supply points which are registered to take a Class 1 or Class 2 settlement product attract a much smaller allocation of UIG. Whilst some of this cost may be recovered through subsequent reconciliation, it is forecast that there will be around 5,958 GWh of irreconcilable and therefore permanent UIG usage.⁶

The modification proposal

UNC665 modifies two key elements of the ratchet regime:

- it replaces the existing Ratchet Charging Arrangements for Class 2 Supply Points with a new "Class 2" Ratchet Charge; and,
- it allows GTs to identify supply points that, notwithstanding their AQ being below the mandatory Class 1 threshold, should be treated as Class 1 and subject to the Class 1 Ratchet Charging Arrangements.

For the avoidance of doubt, shippers will still be required to nominate SPC increases at Class 2 sites where such additional peak capacity is required, and as such will attract higher capacity charges in accordance with the UNC, but will not incur a liability charge in its current form.

UNC Panel⁷ recommendation

At its meeting of 21 March 2019, the UNC modification panel unanimously supported the implementation of UNC665.

Our decision

We have considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 21 March 2019. We have considered and taken into account the responses to the industry consultation(s) on the modification proposal which are attached to the FMR⁸. We have concluded that:

- implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC;⁹ and
- directing that the modification be made is consistent with our principal objective and statutory duties.¹⁰

⁶ The Allocation of Unidentified Gas Expert forecast permanent UIG for 2019/20 to be 5,958 GWh. The total value of 2019/20 UIG will fluctuate in line with the wholesale price of gas. For further information on UIG see the [2019/20 AUGÉ statement](#).

⁷ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

⁸ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.co.uk

⁹ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, available at: <https://epr.ofgem.gov.uk/Content/Documents/Standard%20Special%20Condition%20-%20PART%20A%20Consolidated%20-%20Current%20Version.pdf>

Reasons for our decision

We note the strong support for the implementation of this proposal, with eleven of the twelve respondents offering support, and one offering qualified support.

In our decision letter rejecting UNC0619/A/B we stated that:

*"We encourage industry parties to identify a suitable classification of relevant Supply Points which **maintains the safeguards** around accurate capacity declarations, as historically provided by the ratchet regime, **whilst increasing the frequency and quality of meter read data** being submitted to the Central Data Services Provider".¹¹*

We consider that UNC665 should meet both of these aims. We agree with the UNC panel and consultation respondents who considered that this proposal should be considered against both relevant objectives (a) and (d), and that it would have a neutral impact upon the other relevant objectives.

(a) the efficient and economic operation of the pipe-line system

Our concern with the earlier proposal UNC619/A/B was that it could weaken the deterrent on shippers to correctly declare the capacity of their DM Supply Points (so shippers would be more likely to under declare), meaning that GTs would be unable to rely on the accuracy of capacity declarations. We considered that the industry should be seeking to maximise the amount of accurate, forward looking supply point information that is supplied to the GDNs, so that their pipe-line systems can be efficiently and economically operated. We also recognised that the potential exposure to ratchet liabilities was discouraging the greater take up of DM settlement product classes; an outcome which benefits neither shippers nor the GDNs. We note the consumer response to the UNC665 consultation, who confirmed that this had indeed been their experience.

We consider that UNC665 will increase the accuracy of capacity declarations. Rather than the Class 1 settlement product being defined exclusively in reference to AQ (for those supply points with an AQ above 58,600,000 kWh), GTs will now be able to designate that additional sites should be treated as Class 1. This designation will be subject to certain published criteria being met. The criteria would indicate whether certain supply points would present a material risk to the GTs ability to manage the pipeline efficiently, economically and in accordance with their safety case, unless they are subject to Class 1 UNC rules. These rules would include the application of the ratchet incentive.

The GT would be able to take into account all relevant circumstances, including those which may be site-specific or limited to a given geographic location, or stretch of pipeline. This places a greater burden of evidence upon the GT and may expose some supply points to the ratchet regime that were not previously exposed. We consider that this risk-based assessment is more appropriate than any given AQ threshold alone. We also note that there would be a mechanism for the shipper to appeal the GT's designation if they consider it to be inappropriate.

¹⁰ The Authority's statutory duties are wider than matters which the Panel must take into consideration; they are detailed mainly in the Gas Act 1986 as amended.

¹¹ <https://www.ofgem.gov.uk/publications-and-updates/application-re-calculate-ratchet-charges-unc619-unc619a-and-unc619b>

We consider that this risk-based and dynamic mechanism will better enable the GTs to safeguard their management of the network than the existing rules. In particular, it will ensure that any sites which pose a risk to the network will be DM, rather than rely on the AQ threshold or the shippers' choice of settlement product. At the same time, the removal of automatic application of ratchet charges to Class 2 supply points should encourage shippers to make greater use of this DM product, which will be of benefit both to them and to the GTs.

(d) the securing of effective competition between relevant shippers

The purchase of energy is a key component of gas shippers' and suppliers' costs, making up around 40%¹² of the end consumer's bill. Efficient operators are able to differentiate themselves from competitors by passing through efficiencies in the form of lower tariffs. Cost reflective charging therefore facilitates competition between relevant gas shippers and suppliers.

Much of the benefit of Project Nexus was expected to come from reforms to the gas settlement arrangements. Whilst NDM supply points are now capable of being individually reconciled, they are still allocated and initially settled on the basis of profiled estimates of consumption. The relative inaccuracy of these profiles is considered to be one of the biggest contributors to the daily volume of UIG.

Moving supply points and their gas consumption out of the NDM profiling arrangements (settlement product Classes 3 and 4) and into the DM regime (settlement product Classes 1 and 2) can be expected to improve the accuracy of gas allocation, with corresponding reductions to the levels of UIG. However, despite the large number of supply points with the capability to provide daily reads the take up of the Class 2 settlement product has to date been very limited. As of 24 March 2019, the classification of supply points by settlement products was as follows: ¹³

Class	Total MPRN Count	Total Smart MPRN Count	Total AMR MPRN Count	Total LSP Count
1	537			537
2	631		20	631
3	98919	38315	30755	32085
4	24243555	7229992	170358	246578

The risk of exposure to ratchet liability charges is considered to be one of the main reasons for the limited take up of the Class 2 settlement product. UNC665 removes that liability. However, other relevant rules will continue to apply, including the requirement for shippers to nominate the correct level of SPC, which will be more accurate than relying upon profiled consumption. Therefore, in addition to improving the accuracy of gas allocation, UNC665 should ensure that shippers capacity charges more accurately reflect the costs they impose on the system. We therefore consider that the implementation of UNC665 will further facilitate relevant objective d).

¹² See: www.ofgem.gov.uk/publications-and-updates/infographic-bills-prices-and-profits

¹³ Data provided by Xoserve.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters licence, the Authority hereby directs that modification proposal UNC665: '*Changes to [the] Ratchet Regime*' be made.

David O'Neill

Head of Gas Systems, Energy System Transition
Signed on behalf of the Authority and authorised for that purpose