

Modification proposal:	Uniform Network Code (UNC) 0619/A/B: Application of proportionate ratchet charges to daily read sites (UNC619); Protection from ratchet charges for daily read customers with an AQ of 73,200kWh and below (UNC619A); Application of proportionate ratchet charges to daily read sites (UNC619B)		
Decision:	The Authority ¹ has decided to reject this modification ²		
Target audience:	UNC Panel, Parties to the UNC and other interested parties		
Date of publication:	27 July 2018	Implementation date:	n/a

Background

A ratchet charge is a penalty charge applied to shippers at any daily metered (DM) supply point where gas flows exceed the registered daily capacity amount during the winter period (October-May). The ratchet charge regime is intended to deter shippers from setting their daily capacity requirements below what is actually needed at times when demand is at its highest. The regime intends to incentivise accurate capacity signals, which in turn should assist the Gas Distribution Network (GDN) operators run their pipe-line systems efficiently and economically.

Prior to the implementation of project Nexus in June 2017³, daily meter status was restricted to meters where annual flows (referred to as the Annual Quantity⁴ (AQ)) were greater than 73,200 kWh. Following project Nexus, this lower limit was removed. This has enabled DM-capable Supply Points whose annual flows are less than 73,200 kWh to be nominated by their shipper into the DM product classes ('settlement product Class 2').

The proposers of UNC619 and UNC619B dispute the need for Ratchet Charges. In their view, the distribution networks are unconstrained and therefore Ratchet Charges are unnecessarily penal. They claim that Ratchet Charges result in shippers over-declaring capacity, making it unavailable to other network users. They also claim that they act as a barrier to shippers nominating their DM-capable Supply Points into the DM product classes as the risk of incurring Ratchet Charges outweighs the benefits of daily settlement. Consequently, UNC619 and UNC619B seek to reform the way Ratchet Charges are applied to all DM Supply Points.

The proposer of UNC619A does not think that the distribution networks are unconstrained. It says that whilst accurate capacity declarations are not needed for Smaller Supply Points⁵ (where gas consumption can be modelled), they are necessary for Larger Supply Points⁶ where daily offtake quantities cannot be modelled and where capacity exceedances might impact the efficient and economic operation of the pipe-line

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 <https://www.gasgovernance.co.uk/0432>

⁴ AQ is an estimate of the amount of gas (kWh/annum) that would be offtaken at a Supply Point in a 12 month period.

⁵ Smaller Supply Points are those with an annual offtake of gas less than 73,200 kWh/annum.

⁶ Larger Supply Points are those with an annual offtake of gas greater than 73,200 kWh/annum.

system. Accordingly UNC619A seeks the reform of Ratchet Charges but for Smaller Supply Points only.

The modification proposals

UNC619 was raised by Gazprom (in its role as a shipper) and proposes to re-calculate Ratchet Charges so that they recover avoided transportation charges, had the capacity not been under-stated. UNC619 also seeks to extend the scope of Ratchet Charges to recover avoided transmission charges⁷, which are currently not captured by the regime. The proposer considers that UNC619 will remove a barrier to shippers nominating their DM-capable Supply Points into the DM product classes and that this will result in product innovation and improved cost targeting. The proposer states that this will benefit competition in the marketplace and better facilitate competition.

UNC619A was raised by Scotia Gas Networks (SGN: a gas transporter) and proposes to replace Ratchet Charges with a recovery charge for DM Supply Points which fall into the smaller category. The recovery charge would seek to recover avoided transportation charges, had the capacity not been under-stated. It also proposes to allow the capacity to ratchet above the Provisional Maximum Supply Point Capacity (PM SPC) without a prior referral to the Transporter for feasibility⁸. Ratchet Charges would remain *as-is* for all Larger Supply Points. SGN thinks that UNC619A will ensure the continued application of Ratchet Charges “as per the original intention of the regime – i.e. to apply to those sites which, due to larger consumption, could have a material impact upon network management procedures” whilst protecting DM Smaller Supply Points from Ratchet Charges. It states that this will better facilitate relevant objectives a), b) and c).

UNC619B, which was raised by Centrica (a shipper), is broadly the same as UNC619, except that it proposes to levy an additional 10% “incentive charge” on the re-calculated Ratchet Charge. It also seeks to make an additional adjustment to how Ratchet Charges are calculated by removing PM SPC from consideration when Ratchet Charges are applied. This would enable Ratchet Charges to be levied on a Supply Point even if the transporter did not permit the capacity to be ratcheted in the event that the PM SPC was exceeded. Under current arrangements, Ratchet Charges are not levied in the event that the capacity is exceeded but the transporter does not permit the capacity to be ratcheted. Centrica thinks that the PM SPC “cap” creates a gaming opportunity for shippers to avoid Ratchet Charges by deliberately under-declaring capacity. It considers that UNC619B will remove a barrier to shippers nominating their DM-capable Supply Points into the DM product classes, whilst maintaining a proportionate incentive to ensure accurate capacity declarations. Centrica states that this will result in product innovation and improved cost targeting, and that this will benefit competition in the marketplace and better facilitate relevant objective d).

All three modification proposals were assessed by UNC Workgroup 0619 – “Application of proportionate Ratchet Charges to daily read sites”. The Workgroup report was sent for industry consultation in January 2018. There were 16 consultation responses, of which five gave a preference for UNC619, six for UNC619A and five for UNC619B.

⁷ This includes National Transmission System (NTS) Exit charges are passed through to Distribution Network Operators by the NTS operator, National Grid, and represent the cost of exiting gas from the NTS onto the distribution networks. Ordinarily, these charges are levied on Supply Points.

⁸ The Provisional Maximum SPC (PM SPC), in respect of a DM SP, is the lesser of two times the Prevailing Supply Point Capacity and 16 times the Supply Point Offtake Rate (kWh/hour). Ordinarily, where the sum of the Capacity Ratchet Amount and the User's Registered capacity would exceed the PM SPC, the Ratcheted SPC is capped at the PM SPC until such time as the transporter has assessed the feasibility of the PM SPC being exceeded.

UNC Panel⁹ recommendation

At the UNC Panel meeting on 15 March 2018, a majority of the UNC Panel considered that UNC619A would better facilitate the UNC objectives and the Panel recommended its approval. The Panel decided not to recommend UNC619 and UNC619B for implementation.

We are disappointed that the views of Panel members regarding which objectives they considered were affected, and the rationale for their recommendation, were not recorded. This is not how we would expect an efficient, transparent panel process to run.

Our decision

We have considered the issues raised by the modification proposals and the Final Modification Report (FMR) dated 16 March 2018. We have considered and taken into account the responses to the industry consultation on the modification proposals which are attached to the FMR¹⁰. We have concluded that implementation of the modification proposals will not facilitate better the achievement of the relevant objectives of the UNC.¹¹

Reasons for our decision

We have assessed the modification proposals against relevant objectives a), b), c) and d), and consider they have a neutral impact on the other relevant objectives.

Relevant objective (a) the efficient and economic operation of the pipe-line system to which this licence relates;

Relevant objective (b) so far as is consistent with sub-paragraph (a), the 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.

The modification proposers, Workgroup participants and industry consultation respondents had a range of views on the impact of the proposals on relevant objectives a) and b).

The Workgroup impact assessment notes that some Workgroup participants considered that UNC619 and UNC619B could have a negative impact on the efficient and economic operation of the distribution networks. In their view, an absence of Ratchet Charges would mean that GDNs would be unable to rely on the accuracy of capacity declarations. This view was also expressed by some respondents to the industry consultation. Some respondents were also concerned that UNC619A could result in shippers under-declaring the capacity of their Supply Points in the smaller category, although the link with relevant objectives a) and b) was not made.

⁹ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

¹⁰ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.co.uk

¹¹ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: <http://epr.ofgem.gov.uk/Pages/EPRInformation.aspx?doc=http%3a%2f%2fepr.ofgem.gov.uk%2fEPRFiles%2fStandard+Special+Condition+PART+A+-+Consolidated+-+Current+Version.pdf>

We agree with those parties who think that UNC619 and UNC619B could have a negative impact on relevant objectives a) and b) by weakening the deterrent on shippers to under-declare the capacity of their DM Supply Points. Our view extends to UNC619A. We think that ideally, industry should be seeking to maximise the amount of accurate, forward looking Supply Point information that is supplied to the GDNs, in order that their pipe-line systems can be efficiently and economically operated. However, we also recognise that the current classification of Supply Points that are exposed to the ratchet regime may be acting as a barrier to DM-capable Supply Points being nominated into the DM product classes. This might result in a continued reliance on capacity profiling for DM-capable Supply Points, an outcome which is of benefit to neither shippers nor the GDNs. We think there could be benefit in a solution that enables GDNs to continue to discharge their duties under relevant objectives a) and b), whilst enabling shippers, and by extension consumers, to benefit from DM-capable Supply Points being nominated into the DM product classes.

We disagree with the proposer of UNC619A that its proposal would have a positive impact on relevant objectives a) and b). Our view is that this assessment has not been made against the UNC, but has instead been made against the other two proposals. We do not see how replacing incentivised capacity declarations with empirically modelled data could have a positive impact on relevant objectives a) and b).

Relevant objective (c) so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence

We note that SGN thought that UN619 and UNC619B could have a negative effect on its ability to discharge its licence obligations because the proposals affected the "adequate arrangements" which enable it to meet its Safety Case. Conversely, it stated that its proposal, UNC619A, would have a positive impact on relevant objective c).

We consulted with the Health and Safety Executive (HSE) on the Safety Case matter. In its response, the HSE recognised that GDNs typically refer to the UNC as part of the package of measures in place to safely control the flow of gas through their networks. HSE also noted that should there be significant changes to the UNC, GDNs should be expected to identify the potentially vulnerable parts of their networks and take appropriate measures to ensure that they were no less safe than before the changes.

We have noted the views of the HSE on the Safety Case matter, and are not convinced that UNC619 and UNC619B could have a negative impact on relevant objective c). We disagree with the proposer of UNC619A that its proposal will have a positive impact on relevant objective c). Our view is that this assessment has not been made against the UNC but has instead been made against the other two proposals.

Relevant objective (d) so far as is consistent with sub-paragraphs (a) to (c) the 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***

The proposers of UNC619 and UNC619B considered that their proposals would result in product innovation and improved cost targeting, and would therefore have a positive impact on relevant objective d). However, they did not provide any evidence or narrative as to how. Conversely, some Workgroup participants and consultation respondents were of the view that the proposals could have a neutral or negative impact on relevant

objective d) because of the reduction/removal of consequences resulting from under-declaring capacity.

One consultation respondent was of the view that UNC619A was unduly discriminatory because it adopted a different approach to Supply Points on the basis of annual offtake of gas alone. Similarly, one respondent suggested the proposal could result in the Larger Supply Point market cross-subsidising the Smaller Supply Point market. Another noted that the removal of 'penalty' for under-declaring capacity would provide a free 'one-way bet' for shippers.

In respect of the view that UNC619 and UNC619B could have a positive impact on relevant objective d) we do not consider that the reasons expressed are sufficiently developed or quantified for us to take them into consideration when reaching our overall decision on the proposal, given our views on the potential negative impact on relevant objectives a) and b).

Next steps

As noted above and in our 7 June 2018 minded to position¹² on 'unidentified gas',¹³ the current classification of Supply Points that are exposed to Ratchet Charges may be acting as a disincentive to DM-capable Supply Points being nominated into the DM product classes. There are around 300 mandatory DM (or 'Class 1') Supply Points, while as of the beginning of June 2018, the take up of Class 2 was less than 100.¹⁴ We consider that this low DM population not only undermines the effectiveness of the ratchet regime in incentivising accurate capacity declarations (because for non-daily-metered Supply Points, the capacity is profiled), but also has an adverse effect on the accuracy of gas settlements, particularly in respect of the daily volumes of unidentified gas. To the extent that the cost of gas is not accurately allocated, this could in turn adversely affect competition between gas shippers.

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. We do not consider that any of the UNC619 proposals strikes an appropriate balance between these aims.

¹² See: [Ofgem minded to position and initial impact assessment on UNC modification proposals 642, 642A and 643](#).

¹³ Unidentified gas is gas which cannot be attributed to metered or estimated consumption, shrinkage or gas used by the gas transporter.

¹⁴ Source: Xoserve

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority has decided that modification proposals:

- UNC619 - Application of proportionate ratchet charges to daily read sites;
- UNC619A - Protection from ratchet charges for daily read customers with an AQ of 73,200kWh and below;
- UNC619B - Application of proportionate ratchet charges to daily read sites;

should not be made.

Andrew Burgess

Deputy Director – Energy Systems Transition

Signed on behalf of the Authority and authorised for that purpose.