

0418A: Review of LDZ Customer Charges



The Modification proposes a review of the LDZ Customer charges to base them on current Network costs.



The Proposer recommends that this modification is assessed by the Workgroup



High Impact:



Medium Impact:
Distribution Networks



Low Impact:

Contents

- 1 Summary
- 2 Why Change?
- 3 Solution
- 4 Relevant Objectives
- 5 Impacts and Costs
- 6 Implementation
- 7 The Case for Change
- 8 Legal Text
- 9 Recommendation

About this document:

This document is a modification, which will be presented by the Proposer to the Panel on 15 November. The Panel will consider the Proposer's recommendation, and agree whether this modification should proceed to consultation or be referred to a Workgroup for assessment.



3 **Any questions?**

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0418A

Modification

06 November 2012

Version 1.0

Page 2 of 13

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1 Summary

Is this a Self-Governance Modification

The implementation of this Modification could have an impact on competition between Shippers and therefore it is not proposed that this modification follows the self-governance route.

Why Change?

The DNs have been carrying out a programme of work agreed with Ofgem shortly after Network Sale to make the LDZ transportation charges more cost reflective by basing them on DN specific costs rather than the national costs on which the charges were based at Network Sale. DNPC05 reviewed the split of DN costs between System costs and Customer costs and put the split on a DN specific basis. DNPC08 reviewed the structure of the LDZ System charges and put them on a DN specific basis. The DNs are now in a position to review the structure of the LDZ Customer charges and to put them on a DN specific basis. This is the last structural change outstanding in the programme of work agreed with Ofgem.

Solution

The DNs are proposing not just that the Customer charges be put on a DN specific basis but also that the structure of the charges should be made more cost reflective.

Impacts & Costs

A restructuring of the customer charges will cause some end-users to experience increases in their transportation charges and some to experience reductions. Potential impacts are highlighted.

There may be some xoserve costs as a result of changing the charging functions but it is not envisaged that there would be any increased administration costs to shippers.

Implementation

Because it is recommended that this proposal should be assessed by a Workgroup a timescale for the implementation of the Modification is not currently proposed. However as this proposal involves changes to the LDZ transportation charges and the charge change date specified in the DNs' Licences is 1 April it is suggested that the target implementation date should be 1 April 2014.

The Case for Change

The case for change is to improve the cost reflectivity of the LDZ Customer charges and to complete the programme of work agreed with Ofgem to put all the LDZ transportation charges on a DN specific basis.

Recommendations

It is recommended that this modification should be assessed by Workgroup 0418.

0418A

Modification

06 November 2012

Version 1.0

Page 3 of 13

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2 Why Change?

The DNs have been carrying out a programme of work agreed with Ofgem shortly after Network Sale to make the structure of the LDZ transportation charges more cost reflective by basing it on DN specific costs rather than the national costs on which the structure was based at Network Sale. DNPC05 reviewed the split of DN costs between System costs and Customer costs and put the split on a DN specific basis. DNPC08 reviewed the structure of the LDZ System charges and put that on a DN specific basis. The DNs are now in a position to review the structure of the LDZ Customer charges and to put it on a DN specific basis. This is the last structural change outstanding in the programme of work agreed with Ofgem, although all of the above items may be subject to periodic review over the next price control period.

The work to put the structure of the customer charges on a DN specific basis has inevitably involved reviewing the existing structure with a view to improving the extent to which the charges to supply points of different sizes reflect the costs which those supply points cause to be incurred. Currently, apart from the relatively small fixed charges in the charging band 73.2-732MWh all customer charges are based on supply point capacity (SOQ). The DNs have been examining whether, given the costs which are reflected in the customer charges, an alternative charging structure might be more cost-reflective.

The costs reflected in the customer charges are:

Supply Point Emergency Service Costs: These costs are mainly the costs of the emergency teams which are called out when a leak is reported downstream of the main. The costs of call-outs relating to mains are not included as these are included as LDZ system costs. The costs include an allocation of call centre costs and overheads. From the DNs' investigations there is no evidence to show that these costs vary with the size of the supply point SOQ.

Services Replacement Costs (Repex): These costs are the costs of the replacement of services funded by the transporter or adopted by them. The cost evidence available provides a breakdown into costs for domestic and non-domestic supply points, but is not sufficiently detailed to provide evidence that costs vary by supply point size within the categories of domestic and non-domestic.

Leakage is a relatively small element of the costs associated with services which is too small to be treated as a separate cost category. It is included with Replacement because for the purposes of cost recovery this is the most appropriate cost category.

Asset Related Costs: Services Depreciation: The depreciation costs reflected in the customer charge are almost entirely depreciation of the capital cost of services funded by the transporter. Since the separation of the British Gas Corporation into Transportation and Trading in 1994 the great majority of these costs have been the cost of the Domestic Load Connection Allowance (DLCA). The DLCA is a statutory allowance set out in the Gas Act (1985) and under it the transporter does not charge for the first 10 metres of service laid in public property to domestic properties situated within 23 metres of an existing main. Since 1994 all non-domestic connections and other domestic connections have been funded by the connectee, and therefore the great majority of the depreciation on services which is reflected in the customer charge can be attributed to the DLCA. There may be some depreciation relating to non-domestic services dating back to before 1994 when many British Gas Regions gave Load Connection Allowances to non-domestic connections, but the proportion this represents of the total is now very low.

0418A

Modification

06 November 2012

Version 1.0

Page 4 of 13

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Asset Related Costs: Network Rates: The Network Rates reflected in the customer charge are based on the same capital cost of services funded by the transporter as the depreciation and are treated in the same way.

The table below shows the relative importance of the costs which are reflected in the customer charges for each Network.

	Scotland	Southern	Wales & West	Northern
Emergency:				
Direct Costs	18.1%	17.3%	16.5%	14.1%
Opex+Work Management	3.6%	2.8%	5.0%	2.9%
Total Emergency	21.7%	20.0%	21.5%	17.0%
Replacement:				
Direct Costs	27.6%	32.4%	26.6%	22.1%
Opex+Work Management	5.4%	5.2%	8.1%	4.5%
Service Leakage	2.0%	2.1%	2.8%	2.6%
Total Replacement	35.0%	39.6%	37.5%	29.1%
Asset Related Costs:				
Regulated Depreciation	29.8%	25.1%	26.8%	32.7%
Network Rates	13.5%	15.3%	14.1%	21.2%
Total Asset Related Costs	43.3%	40.4%	41.0%	53.9%
Total	100.0%	100.0%	100.0%	100%

	East of England	London	North West	West Midlands
Emergency:				
Direct Costs	15.9%	20.1%	19.6%	16.8%
Opex+Work Management	3.4%	6.0%	4.7%	3.7%
Total Emergency	19.3%	26.1%	24.4%	20.5%
Replacement:				
Direct Costs	21.1%	19.6%	26.1%	26.6%
Opex+Work Management	4.6%	5.8%	6.3%	5.9%
Service Leakage	2.1%	1.8%	2.2%	2.1%
Total Replacement	27.8%	27.2%	34.5%	34.6%
Asset Related Costs:				
Regulated Depreciation	30.1%	28.6%	25.7%	27.9%
Network Rates	22.8%	18.1%	15.5%	17.0%
Total Asset Related Costs	52.9%	46.7%	41.1%	44.9%
Total	100.0%	100.0%	100.0%	100.0%

Revenue Recovery: The actual level of the charges will be adjusted to ensure that the revenue recovered is in line with the System/Customer Charge split established in DNPC05.

0418A

Modification

06 November 2012

Version 1.0

Page 5 of 13

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3 Solution

Proposal

For the avoidance of doubt, this alternative proposal only seeks to change the charging methodology for the asset related costs, to a flat unit rate (pence/kWh) rather than the single flat rate (pence/supply point/day).

Currently, apart from the relatively small fixed charges in the charging band 73.2-732MWh all customer charges are based on supply point capacity (SOQ). There are three charging bands:-

1. 0-73.2 MWh: For supply points with an AQ below 73.2MWh there is a fixed unit rate in terms of pence per peak day kWh per day.
2. 73.2 - 732 MWh: For supply points with an AQ between 73.2 and 732 MWh there is also a fixed, but lower, pence per peak day kWh per day unit rate, plus the fixed charge depending on frequency of meter reads.
3. >732 MWh For supply points with an AQ greater than 732 MWh the unit rate depends on the SOQ of the supply point as it is calculated using an exponential function.

This Mod is proposing a more cost reflective charging structure based on the costs reflected in the Customer Charges. The charge would consist of three parts, reflecting the three main types of costs which are recovered through the customer charges. With the first two elements, Emergency costs and Services Replacement costs, the charges are set to be as cost reflective as possible given the evidence available. For the third element, Depreciation (mainly DLCA) costs, two options were initially proposed for consideration by the Workgroup. After consideration by the DNs Option 2 was discounted (charging based on the square root of the SOQ) as no substantial evidence could be found to justify charging on this basis. The Mod 418 workgroup therefore decided by majority Option 1 would be used as the method for charging of the Depreciation Costs, however, this alternative modification is proposing a third option in relation to the recovery of Depreciation costs. This Option 3 is a pence/kWh approach. Option 3 was raised at the working group at three separate meetings and the DNs agreed to look at the impact.

The proposed charges will also be more cost reflective than the existing charges because they will be based on individual DN costs rather than national costs and will reflect an up-to-date balance of costs involved.

Emergency Costs: Because there is no evidence that supply point Emergency costs vary with supply point size it is proposed that these costs be recovered by a single flat rate charge which would apply to all supply points, irrespective of size.

Services Replacement Costs (Repex) In most Networks there is cost evidence that Services Replacement costs are higher for non-domestic supply points than for domestic supply points, which is to be expected on the basis that non-domestic supply points will, on average, have larger services. However the available cost data is not sufficiently detailed to provide evidence that costs vary by supply point size within the categories of domestic and non-domestic. Therefore for these Networks it is proposed that there should be one flat rate for the 0-73.2 MWh charging band, which consists mainly of domestic supply points, and a slightly higher flat rate for the 73.2 – 732

0418A

Modification

06 November 2012

Version 1.0

Page 6 of 13

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MWh and >732 MWh charging bands which consist mainly of non-domestic supply points. In Southern Network the cost evidence does not justify a higher rate for the 73.2 – 732 MWh and >732 MWh charging bands and therefore a single flat rate charge across all three charging bands is proposed.

Asset Related (DLCA) Costs: As discussed in Section 2, the great majority of the asset related costs on services which are reflected in the customer charge can be attributed to the DLCA. The proposers of the Mod consider that it was the intention of the Gas Act (1985) that the cost of the DLCA should be recovered from all gas customers and not just from those who benefitted from the Allowance. This part of the charge is not intended to be cost reflective because it is to recover an allowance and not an operational cost.

This Modification proposes the following option for charging of the asset related costs based on a flat unit rate charge (pence/kWh) applied to all Supply Points irrespective of size. This would mean that the Depreciation costs would be recovered from all supply points, but with no attempt to vary the charge by size of supply point.

Impacts on Charges

There would be a flat rate charge for Emergency costs and Replacement costs. For Emergency costs there would be a single flat rate charge (pence/supply point/day) across all supply points, and for Replacement for seven of the eight Networks there would be one flat rate (pence/supply point/day) for the 0-73.2 MWh charging band and a higher flat rate (pence/supply point/day) for the other two charging bands. For Southern Network there would be the same flat rate charge across all load bands (pence/supply point/day).

For Asset Related costs there would be a flat unit rate (pence/kWh) applied to all supply points.

Impact assessment to be provided by the working group.

4 Relevant Objectives

Impact of the modification on the Relevant Methodology Objectives:	
Relevant Objective	Identified impact
a) save in so far as paragraphs (aa) or (d) apply, that compliance with the charging methodology results in charges which reflect the costs incurred by the licensee in its transportation business;	Positive
aa) that, in so far as prices in respect of transportation arrangements are established by auction, either: (i) no reserve price is applied, or (ii) that reserve price is set at a level - (I) best calculated to promote efficiency and avoid undue preference in the supply of transportation services; and (II) best calculated to promote competition between gas suppliers and between gas shippers;	None
b) that, so far as is consistent with sub-paragraph (a), the charging methodology properly takes account of developments in the transportation business;	Positive
c) that, so far as is consistent with sub-paragraphs (a) and (b), compliance with the charging methodology facilitates effective competition between gas shippers and between gas suppliers; and	None
d) that the charging methodology reflects any alternative arrangements put in place in accordance with a determination made by the Secretary of State under paragraph 2A(a) of Standard Special Condition A27 (Disposal of Assets).	None
e) 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

Objective a)

This Mod proposal would better facilitate the achievement of Objective a) above by having the structure of LDZ customer charges for each DN reflect the costs of that DN instead of reflecting national costs.

Objective b)

This Mod proposal would better facilitate the achievement of Objective b) above because it would make the structure of the LDZ customer charges reflect the existing structure of the distribution networks.

This Modification proposal would affect only the Customer Charges themselves and has no impact on compliance with paragraphs 2, 2A and 3 of Standard Special Condition A4 of the Transporter's Licence.

0418A

Modification

06 November 2012

Version 1.0

Page 8 of 13

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5 Impacts and Costs

Consideration of Wider Industry Impacts

None

Costs

Indicative industry costs – User Pays
Classification of the modification as User Pays or not and justification for classification
Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification
Proposed charge(s) for application of Users Pays charges to Shippers
Proposed charge for inclusion in ACS – to be completed upon receipt of cost estimate from Xoserve

Impacts

Impact on Transporters' Systems and Process	
Transporters' System/Process	Potential impact
UK Link	• None
Operational Processes	• None
User Pays implications	• None

Impact on Users	
Area of Users' business	Potential impact
Administrative and operational	• None
Development, capital and operating costs	• None
Contractual risks	• None
Legislative, regulatory and contractual obligations and relationships	• None

Impact on Transporters

0418A

Modification

06 November 2012

Version 1.0

Page 9 of 13

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Impact on Transporters	
Area of Transporters' business	Potential impact
System operation	• None
Development, capital and operating costs	• None
Recovery of costs	• None
Price regulation	• None
Contractual risks	• None
Legislative, regulatory and contractual obligations and relationships	• None
Standards of service	• None

Impact on Code Administration	
Area of Code Administration	Potential impact
Modification Rules	• None
UNC Committees	• None
General administration	• None

Impact on Code	
Code section	Potential impact
TPD Y	• None
	•

Impact on UNC Related Documents and Other Referenced Documents	
Related Document	Potential impact
Network Entry Agreement (TPD I1.3)	• None
Network Exit Agreement (Including Connected System Exit Points) (TPD J1.5.4)	• None
Storage Connection Agreement (TPD R1.3.1)	• None
UK Link Manual (TPD U1.4)	• None
Network Code Operations Reporting Manual (TPD V12)	• None
Network Code Validation Rules (TPD V12)	• None

0418A

Modification

06 November 2012

Version 1.0

Page 10 of 13

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Impact on UNC Related Documents and Other Referenced Documents	
ECQ Methodology (TPD V12)	• None
Measurement Error Notification Guidelines (TPD V12)	• None
Energy Balancing Credit Rules (TPD X2.1)	• None
Uniform Network Code Standards of Service (Various)	• None

Impact on Core Industry Documents and other documents	
Document	Potential impact
Safety Case or other document under Gas Safety (Management) Regulations	• None
Gas Transporter Licence	• None

Other Impacts	
Item impacted	Potential impact
Security of Supply	• None
Operation of the Total System	• None
Industry fragmentation	• None
Terminal operators, consumers, connected system operators, suppliers, producers and other non code parties	• None

6 Implementation

Because it is recommended that this proposal should be assessed by a Workgroup a timescale for the implementation of the Modification is not currently proposed. However as this proposal involves changes to the LDZ transportation charges and the charge change date specified in the DNS' Licences is 1 April it is suggested that the target implementation date should be 1 April 2014.

7 The Case for Change

In addition to that identified the above, the Proposer has identified the following:

Advantages

The proposal has the advantages that it would improve the cost reflectivity of the customer charges and place them on a DN specific basis.

This alternative modification also has the following advantages over the original modification (Mod 418):

- By recovering the asset related costs on a pence/kWh basis, rather on a pence/supply point basis, it better preserves the intent of the DLCA. If the intent of the Gas Act was to recover this allowance from all gas customers then a p/kWh charge would provide a reasonably balanced apportionment of this cost across all customers. On the other hand, a p/supply point charge as proposed in the original modification would in effect recover approximately 98%* of the cost from the group of customers the allowance was intended for, which seems inappropriate. *Source: xoserve, August 2012.
- Where there is a level of cost to be recovered from all customers in a non-cost reflective manner, as is the case for the DLCA, the current practice in the energy industry is to apply a p/kWh charge. Examples of this approach are the NTS SO Commodity charge, the TO Exit Commodity charge and Assistance for Areas with High Electricity Distribution Costs allowance (AAHEDC). This alternative proposal maintains current industry practice. On the other hand, there are no examples of a pence/customer approach to recover a level of cost in a non-cost reflective manner.

Disadvantages

8 Legal Text

To be provided.

9 Recommendation

The Proposer invites the Panel to:

- DETERMINE that Modification 0418A progress to Workgroup