

Modification proposal:	Uniform Network Code (UNC) 244, 244A and 244B: "Amending DM Supply Point Data for Sites with Significant Changes in Usage".		
Decision:	The Authority ¹ does not direct that either of these proposals be made ²		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	20 May 2009	Implementation Date:	Not Applicable

Background to the modification proposal

Under the current UNC arrangements if a user wishes to reduce the amount of gas it takes off the system it is still liable for the capacity element of its charges corresponding to its historic level of gas off-take.

Customers are categorised as Daily Metered (DM) or Non Daily Metered (NDM). Depending on whether they are a DM or NDM customer the capacity charge is calculated using a combination of their Annual Quantity (AQ)³, Supply Point Offtake Quantity (SOQ)⁴ and the Bottom Stop Supply Point Offtake Quantity (BSSOQ)⁵.

For DM customers the capacity charge is based on maximum peak day flow (SOQ) that is registered with a shipper. If a DM customer changes its SOQ requirements the shipper can re-nominate a higher or lower peak day demand with the Gas Distribution Network (GDN). Capacity charges are then immediately recalculated and actual peak day demand is measured and verified. However, customers can only do this in a specified time period once a year between October and January. Further, there are rules preventing the SOQ being less than the BSSOQ (highest capacity for any day during October to May within the preceding year).

NDM customers are treated differently as their peak day demand, SOQ, cannot be measured from metered data and must therefore be estimated. This estimate is based on annual consumption (AQ) and the relevant load factor. SOQ is calculated using the following formula:

$$\text{SOQ} = (\text{AQ} * 100) / (365 * \text{load factor})$$

This means that an NDM receives lower capacity charges if they reduce their annual demand AQ. Further NDMs differ to DMs in that they can reduce their AQ at any time via a 'BTU form' (BTU form process).

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

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

³ AQ- Annual Quantity (AQ) this is annual consumption at a supply point.

⁴ SOQ- Maximum peak day flow is known as Supply Point Off-take Quantity (SOQ).

⁵ Bottom Stop SOQ- This is the highest value of peak day flow (SOQ) measured for the previous year.

The modification proposals

UNC 244 (Corona Energy)

Corona Energy has raised UNC modification 244 to introduce more flexibility for DM users and to address the different treatment of DM and NDM customers. The difference is that the UNC currently allows large supply point NDM sites to reduce their AQ and therefore their SOQ through the BTU form process, thereby reducing their capacity charges. However, there is no ability for DM firm sites or DM interruptible sites to change their SOQ outside of the specified window.

Given the recent economic downturn, Corona Energy argue that certain DM customers cannot wait, and continue to incur high transportation charges, until the window in October to revise down their capacity. They have argued that given this lack of flexibility the only way to avoid paying the capacity charges is to fully vacate a site, withdraw from the supply point and isolate their meters.

They also argue that this issue has not arisen previously because it was only recently that the components of the gas distribution use of system charges were revised as part of the reform of arrangements for interruptible customers. As part of these reforms, changes were approved to the proportion of gas distribution revenues recovered from the capacity and commodity charges. The proportion of revenues recovered from capacity relative to commodity was changed from 50/50 to 95/5. The increase in the proportion of the capacity element of charges meant that even if large users significantly reduce the volume of gas they take off the system this does not alter their transportation charges by a significant amount.

In addition, the recent interruption reform has had another impact. Interruptible customers who are typically large users were not liable for the capacity element of the transportation charges. The recent reform means that more customers have chosen to become firm and/or GDNs have concluded that there is limited or no value in offering interruptible capacity because they have sufficient capacity to meet all firm demands. As a result a large number of users have become firm and are now liable for the capacity component of the charges. This, combined with the change in the capacity/commodity split, has the effect of increasing large users' transportation costs even if they significantly reduce their gas demand. The impact of this on large users has been exacerbated by the recent economic downturn.

Corona Energy proposed that the UNC be modified so that DM sites have a process to amend their capacity (AQs / SOQs / BSSOQs) at any time.

Corona Energy has suggested that DM sites should be able to reduce their capacity, subject to a number of restrictions. For example, the relevant AQ must be decreased by at least 20% and it must be at least at a level of 73,201 kWh. SOQ and BSSOQ must be greater than 1/365 of the AQ and the SOQ must be greater or equal to the BSSOQ. This means in practice that customers cannot reduce the level of capacity that is used to calculate their distribution charges (the SOQ or BSSOQ) to less than their actual use on an average day.

In addition, shippers must warrant that the updated capacity levels are a reasonable estimation for the next 12 months and the site must remain at this level for at least 12 months. However, the shipper can reapply to reduce its capacity again within the 12 months if demand is reduced again, subject to the above thresholds.

Further, users would be charged retrospectively for capacity at the original level in the circumstance where a user reduces capacity then increases capacity at a single supply point within a 12 month period.

It is also noted that if a consumer chooses to use this process to reduce their capacity rights on the distribution network they will no longer have any rights over that capacity.

Two alternatives have been raised by GDNs which seek to place further restrictions than the original proposal on reducing capacity. These are explained below.

UNC 244A (Wales and West Utilities)

This alternative:

- Would not allow for the revision of all supply point capacity data (AQ, SOQ, BSSOQ, SHQ).
- Would allow DM supply points to reduce SOQ all year round but under certain exceptional circumstances and with limits imposed (equivalent to the BTU form process).
- Would only allow exceptional circumstances to apply to DM supply points:
 - if there have been changes at the consumer’s plant;
 - in circumstances at the site that result in changes in gas usage
- Would only be applicable if it is expected in the foreseeable future that gas usage will not increase. A GDN can reject an application if it does not think that this criterion is met.
- Would allow SOQ under the exception to be reduced at no less than BSSOQ outside the normal period where capacity can be reduced. GDNs would not be allowed to reject such a request unless information is missing from the request.
- Would apply the current capacity revision obligations of transporters to exception cases, including obligations to validate a request using meter read information, information on future usage and site visits.

Summary Table: Proposed Capacity Reduction Processes (UNC 244A)

Proposed Supply Point registration Data	Proposed SOQ	Applicable Process
Anytime (Oct-Sept)	Increase	Existing
Oct- Jan (inclusive)** (Capacity Reduction Period)	Decrease (SOQ >= BSSOQ)	Existing
Feb- Sept (inclusive)	Decrease (SOQ >= BSSOQ)	Exception
Anytime (Oct- Sept)	Decrease (SOQ <= BSSOQ)	Exception

UNC 244B (National Grid)

National Grid (244B) proposes temporary changes for a transitory period to reflect demand changes as a result of the economic downturn. National Grid has therefore proposed that arrangements should expire on 30 September 2011. However, it is suggested these transitional arrangements be reviewed by the UNC Distribution Work Stream and extended if necessary.

Other differences from the original proposal include:

- The SOQ would be reduced to below a value of the BSSOQ during the current capacity reduction window (Oct-Jan) if a Supply Point is DM.
- The GDNs would reserve the right to reject capacity reduction requests based on daily read data if it considers that the request is not compliant with the UNC.

UNC Panel recommendation

At the Modification Panel meeting held on 30 April 2009, of the eight Voting Members present, capable of casting nine votes, two votes were cast in favour of implementing Modification Proposal 0244. One Modification Panel Member provided a written vote indicating support for Proposal 0244. At the same meeting, three votes were cast in favour of implementing Alternative Proposal 0244A and one vote was cast in favour of implementing Alternative Proposal 0244B. Therefore the Panel did not recommend implementation of any of these proposals.

The Panel then proceeded to vote on which of the three Proposals would be expected to better facilitate achievement of the Relevant Objectives. Of the eight Voting Members present, capable of casting nine votes, no votes were cast in favour of implementing Proposal 0244 in preference to Alternative Proposals 0244A and 0244B, eight votes were cast in favour of implementing the Alternative Proposal 0244A in preference to Proposals 0244 and 0244B, and two votes were cast in favour of implementing the Alternative Proposal 0244B in preference to Proposals 0244 and 0244A. Therefore, the Panel determined that, of the three Proposals, Proposal 0244A would better facilitate the achievement of the Relevant Objectives.

The Authority's decision

The Authority has considered carefully the issues raised by the modification proposals and the Final Modification Report (FMR) version 2.0, dated 1 May 2009. The Authority has considered and taken into account the responses to the Joint Office's consultation on the modification proposals which are attached to the FMR.

The Authority has decided that the proposals and modification reports provide insufficient evidence to conclude any of the modification proposals would better facilitate the achievement of the relevant objectives of the UNC.

Reasons for the Authority's decision

In coming to our decision we note the varying degree of support for proposals UNC224, UNC224A and UNC224B from written representations received during the consultation on the proposals. We also note that none of the proposals attracted a majority recommendation to implement from the UNC modification panel.

The current regulatory framework, in particular section 9(2) Gas Act 1986, reflects the requirements of the EU Gas Directive 2003/55/EC⁶, prohibiting any undue discrimination in the terms offered by gas transporters to different users and classes of user. It is clear that the current arrangements do provide for different treatment of two classes of user, DM and NDM users in terms of their ability and flexibility to vary their level of charges by varying their use of gas throughout the year. It is therefore important to determine whether there are good reasons justifying this differential treatment.

However, on the basis of the limited evidence and analysis presented in the proposals and modification reports we have not been able to conclude whether this differential treatment remains appropriate or not. We discuss this in more detail below.

We also acknowledge the potential problem of customers facing severe economic hardship because of the current economic climate and that GDNs may have a role to play in assessing whether some form of temporary and transitional relief is appropriate. A significant proportion of the GDNs' costs are sunk and their allowed revenues are no longer linked to system usage. So in the event that a large customer ceases to use the system and to pay any distribution charges, GDNs will recover the money from other customers, whose charges will rise, unless the GDN can find other users who wish to use the capacity freed up as a result.

In these circumstances, it may be appropriate for GDNs to consider whether some form of transitional relief is appropriate if they are convinced that the alternative is that the customer will cease to use the network and GDNs will not recover any charges from that customer, leaving all other customers worse off. But the rules around granting any relief would need to be set carefully to avoid the risk of gaming with customers simply claiming financial hardship to secure a reduction in their charges at other customers' expense. This could be achieved, for example, by making any relief transitional and requiring customers to repay any relief in subsequent years when their circumstances improve.

We welcome the attempts by GDNs to engage in this debate and the two alternative proposals raised to try to achieve this but, for the reasons set out in this letter we do not think either of them as they stand would better facilitate the relevant objectives. The industry may wish to consider whether, in the light of our comments and decision, they wish to consider developing further proposals to address the problem identified. But if they decide to do so we would urge them to provide much more analysis of the likely impact of any changes not only on the customers affected but also on other customers charges and to consider whether the arrangements are sufficiently robust to avoid any potential, gaming.

We would expect that the analysis submitted with any further proposed modifications aimed at allowing GDNs to offer transitional relief to DM customers would be able to demonstrate that those further modifications would not lead to an inappropriate increase in the overall share of costs that are recovered from the rest of the GDN customer base.

⁶ Concerning common rules for the internal market in natural gas

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

Some respondents have argued that the proposal will allow customers to provide accurate and timely information on their gas requirements to the transporters, improving the information available for network operation, and that this will promote efficient and economic operations of the pipeline system.

However, we agree with those respondents who have argued that the implementation of this proposal would not better facilitate this relevant objective as it has the potential to increase the frequency with which sites can reduce and increase (capacity availability permitting) their usage. Under the current regime, when investment decisions are made by GDNs the resulting investment is expected to be recouped from the users that triggered it over time. The proposals could increase the level of stranded investment unless the assets can be utilised by other users.

To the extent that assets become stranded as a result of a short term decrease in usage, the costs of these assets may need to be recouped from other users. This potentially leads to cross subsidies as other network users are required to fund the network investment, even if they did not trigger it.

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

We note that some of the respondents considered that if GDNs have a more accurate view of the gas transportation requirements on their networks, they in turn will be able to provide the NTS with more accurate demand forecasts and capacity bookings. We agree with the respondents who considered that AQs, SOQs, SHQs and BSSOQs that reflect actual usage would help to ensure that the GDNs book an appropriate level of NTS Exit Capacity required for the consumers connected to their system, thereby facilitating this objective.

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

Consideration of these proposals against this objective is primarily in the context of the requirements of Standard Special Condition A5 of the GT licence⁷, which requires that the GTs transportation charging methodologies are cost reflective.

Charging methodology

We agree with the majority of the respondents who felt that none of the modification proposals further this relevant objective and with those that argued that implementation of any of these modification proposals may undermine the basis of the capacity charging regime that exists within the industry.

⁷ Standard Special Condition A5: Obligations as Regard Charging Methodology

Insufficient analysis has been provided about the potential impacts if any of the proposals were implemented and what the potential reduction in DM revenues could be. This could give rise to NDM sites picking up a much greater proportion of GDN costs.

Implementing any of these proposals could lead to inefficient investment and stranded assets, which may in turn lead to shippers and other consumers having to bear these inefficient costs, which would be in direct conflict with this relevant objective.

We therefore consider that the GDNs should consider alternative solutions to target the potential problem identified by Corona and acknowledged by some of the GDNs.

Non-discrimination

While we agree that it would not be appropriate to discriminate between certain types of customers with respect to their ability to reduce their capacity and thus their capacity charges, we note that there is little evidence or analysis on this topic in the Final Modification Report. We are concerned that proper analysis may conclude that, given the nature and size of NDM customers, shippers are making limited use of the BTU form process in practice. Similarly we have seen very limited analysis of the potential impact on any of the proposals on the overall costs to customers.

Relevant objective d) - 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

Many of the arguments that have been used by respondents in relation to relevant objective d) related to cost reflectivity and have therefore already been dealt with above. We agree that the proposals do not further this relevant objective as their effect would be to lead to inefficient investment and a much greater risk of stranded assets, which may in turn lead to NDM consumers (via their shippers) having to bear these costs.

Conclusion

We agree with the majority of the responses which indicate that, while UNC244 may facilitate relevant objective b), none of the three proposals better facilitates the relevant objectives a), c) and d). Indeed, we consider that the proposals are likely to have detrimental impacts against these objectives. This is because the proposals could increase the risks of stranded assets and inefficient investment and/or lead to NDM customers having to bear a disproportionate share of the costs of the gas distribution system. On balance therefore, we have concluded that the proposals do not better facilitate the relevant objectives.

While we agree that it would not be appropriate to discriminate between certain types of customers with respect to their ability to reduce their capacity and thus their capacity charges, we note that there was little evidence or analysis on this topic in the Final Modification Report. We have subsequently been informed by Xoserve that during the 2008 calendar year only 23 BTU form process submissions (from a total of 27) resulted in AQ reductions, aggregating to 214 GWh. Whilst we acknowledge that this may not be indicative of future usage, particularly given the deepening of the economic downturn in early 2009, there is insufficient evidence to conclude that either (i) in practice NDM customers do reduce their capacity with a significant impact on the rest of the customers, or (ii) allowing DM sites to reduce their capacity in a similar way to NDM customers would

not give rise to gaming and lead to a significant and inappropriate increase in the share of GDN costs that are paid for by NDM customers.

We would expect GDNs to carry out (and share with us and the industry) analysis to determine whether the current differential treatment is appropriate and non-discriminatory and to assess the best way of addressing the issue, whether through further modifications or otherwise.

Rachel Fletcher
Director, Distribution

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