Modification proposal:	**Uniform Network Code (UNC) 275: Reduction in DM LDZ Exit Capacity for Supply Points with Significant Changes in Usage (UNC 275)**		
Decision:	The Authority[1] directs that this proposal be made[2]		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	18 December 2009	Implementation Date:	21 December 2009 (To be confirmed by the Joint Office)

Background to the modification proposal

The meter reading requirements set out in the Uniform Network Code (UNC) are determined by the consumption of energy at a site and the relative impact fluctuations in that consumption may have on the operation of the system. If a site typically consumes more than 58,600,000 kWh per year, readings will be taken on a daily basis. Sites are therefore categorised for the purposes of the UNC as either Daily Metered (DM) or Non Daily Metered (NDM). Depending on whether they are a DM or NDM customers their 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].

Under the current UNC arrangements if a DM user wishes to reduce the amount of gas it takes off the system it is still liable for the capacity component of its charges corresponding to its historic level of gas off-take for a period of time. For these customers the capacity charge is based on maximum peak day flow (SOQ) that is registered with their shipper.

If an NDM 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, DM 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).

Certain DM customers have argued that the rules preventing the SOQ being less than the BSSOQ are too restrictive and can lead to customers paying for capacity that does not reflect their use of the network.

UNC 244, which was raised to address this, was rejected by the Authority 20 May 2009[6]. However, we signalled our expectation that GDNs carry out analysis to assess whether there was a better way of addressing the issue, whether through a modification or otherwise.

[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.
[6] The decision letter can be found on our website here:
http://www.ofgem.gov.uk/Licensing/GasCodes/UNC/Mods/Documents1/UNC244D.pdf

In relation to this we acknowledged that in the event that a large user ceases to use the system and to pay any distribution charges, GDNs will recover the cost associated with the unused capacity from other customers, whose charges will rise, unless the GDN can find other users who wish to use that capacity.

In these circumstances we noted that it may be appropriate for the GDNs to consider whether some form of short term flexibility in the rules for capacity booking would be 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. However, we also noted that the rules around granting any flexibility would need to be set carefully to avoid the risk of gaming with customers simply claiming to have experienced a significant drop in demand to secure a reduction in their charges at other customers' expense.

The modification proposal

National Grid (NG) Distribution has raised UNC 275 to introduce more flexibility for DM users to reduce their capacity reservations to a level that better reflects their current capacity usage. The modification is for a limited period only, timing out in January 2011.

Given the recent economic downturn, NG argues that certain DM customers have experienced an unprecedented drop in gas demand, and as a result, are now constrained by a BSSOQ that does not reflect their expected capacity usage. In these cases the BSSOQ represents an overstatement of the capacity they require in the coming year as it is based on the previous year's winter peak capacity. NG points out that, due to the capacity revisions timing, in certain circumstances it may take up to 2 years for a DM customer to be able to change its capacity to reflect reductions in demand. Further, NG argues that, given the current lack of flexibility, the only way to avoid paying capacity charges at the level suggested by the BSSOQ is to fully vacate a site, withdraw from the supply point and isolate the relevant meters.

NG has proposed that the UNC be modified to allow DM users to reduce for a limited period only their SOQ to a level reflective of their gas usage. The purpose is to provide immediate flexibility to those users whose gas consumption has been affected by the downturn but who would otherwise be unable to reduce their capacity below the BSSOQ in the short term. NG has proposed that users may only reduce their capacity to any level during the remaining capacity reduction period (until 31 January 2010) and next year's capacity reduction period (1 October 2010 - 31 January 2011).

Certain restrictions have also been proposed, as follows:

- The revised level of capacity must be lower than the prevailing BSSOQ and the new level must set SOQ and BSSOQ to the same level.

- Shippers must provide a signed declaration from the customer stating:

    - The anticipated peak daily load for the whole gas year (Commencing October 2009 and/or October 2010);
    - The reasons for the change, i.e. downturn in production; and
    - That gas will continue to be offtaken.

- If a customer chooses to use this process to reduce its capacity on the distribution network it will no longer have any rights over that relinquished capacity.

- Customers are only permitted to reduce their capacity once during each capacity reduction period.

Additional measures have been proposed by NG for interruptible customers to ensure they have appropriate incentives to accurately nominate the capacity they require for the forthcoming gas year. If an interruptible customer uses more capacity than it has booked following a downward revision without going through the mechanisms within the UNC to increase capacity, then this user will become liable for avoided transportation charges. These will be calculated as the difference in the charges that would have been levied before the capacity was revised downwards and the transportation charges applied following the revision to capacity.

If a customer does subsequently formally request through the UNC processes an increase in its capacity, this customer will only be liable for the transportation charges that it has avoided up to that point.

NG considers that this proposal better facilitates Standard Special Condition A.11.1 (d). Its view is that the proposal would better enable users to reduce their capacity bookings at DM supply meter points in line with their LDZ exit capacity requirements for the gas year commencing October 2009 and/or October 2010 and is therefore more cost reflective.

UNC Panel[7] recommendation

At the Modification Panel held on 11 December 2009, of the 10 voting members 8 votes were cast in favour of implementing UNC 275, one was cast against implementing and one voter was absent. The Panel therefore voted in favour of implementing the proposal.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 11 December 2009. The Authority has considered and taken into account the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR[8]. The Authority has concluded that:

1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC[9]; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties[10].

[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.com
[9] As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=6547
[10]The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

Reasons for the Authority's decision

We acknowledge the potential problem faced by customers as a result of the current economic climate. As outlined in our previous decision on UNC 244, we consider that the GDNs have a role in assessing whether some form of short term flexibility in capacity booking is appropriate in light of the recent drop in gas demand experienced by some sites as a result of the economic downturn.

We welcome the GDNs' recent engagement with their customers on this matter and for the reasons set out in this letter consider that the proposal goes some way to addressing the issues which caused the previous proposals UNC 244, 244A and 244B to be rejected. We also note that analysis we have undertaken, with the assistance of the GDNs indicates that, in the current economic circumstances, all customers are likely to be better off in the long term if the proposed short term flexibility in capacity booking is provided to DM sites. In addition, we recognise that the proposal goes some way in addressing the concerns regarding gaming by users. However, it should be noted that what we have considered under UNC 275 is a temporary arrangement and should a permanent change to the UNC be proposed we may take a different approach and require a more comprehensive review and indeed evidence than that provided in support of UNC 275.

We note that justification provided by the GDNs of how the proposal better facilitates the relevant UNC objectives in the Final Modification Report is limited. We acknowledge that an objective assessment against the objectives has been made challenging by the limited data provided by customers on the likely up take of the temporary arrangements. This in turn has made our assessment of the impacts of the proposal difficult.

This modification proposal has been developed under reasonably tight timeframes and we note the GDNs intent to propose a more enduring solution at a later date. Given the difficulty we have experienced in assessing the implication of UNC 275 we would encourage industry to examine more closely the effects of any further modification.

Our assessment of the proposal against the relevant objectives and our statutory duties is outlined below.

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

In general the efficient and economic operation of the pipe-line is promoted by ensuring that large customers on the network, whose usage can have a significant impact on the operation of the system, are constrained in the reduction they can make year on year in the volumes of capacity they book. This is the intent behind the capacity charging arrangements for DM customers outlined above, which smoothes out volatility in gas offtake by requiring DM customers to commit to booking at or above a minimum capacity with reference to the previous year's maximum daily offtake.

We have assessed the proposed modification against this objective in the context of the current capacity booking arrangements as well as the current economic recession.

Evidence provided by NG suggests that the SOQ has fallen significantly below the BSSOQ for 24 per cent of the DM customers in its area. With the current capacity booking arrangements, if customers seek to control their capacity charges the only route open to them is to vacate the site or disconnect from the gas network, leaving parts of the pipeline unutilised for a period of time. If this course of action was taken by a significant proportion of DM customers, it would not be in the interests of the efficient and economic operation of the network as it may lead to considerable underutilisation of the network in the longer term. While in any year there is a risk of some large customers disconnecting from the network, the economic recession means the risk of this occurring across a noticeable percentage of DM customers is much higher than at any time since these arrangements were put in place.

In addition to the considerations noted above, we note the following:

- The modification is proposed only as a temporary measure and will fall away automatically on January 2011.

- The proposal includes arrangements to prevent customers from gaming, so that only those that are genuinely experiencing a reduction in gas offtake and that expect this to endure over the coming gas year, will make use of the flexibility being offered.

- The proposals do not represent a fundamental shift from the current arrangements, and simply bring forward the capacity reductions that would be allowed under the current arrangements in the following gas year. We note that the current arrangements do not require DM customers to make a long term commitment to paying for capacity that they have triggered, but simply seek to smooth out the year on year volatility in network use.

We further note that, despite requests to shippers to this effect, we have not been provided with information on how many DM customers would take up the offer of more flexible capacity booking arrangements or how many of them might rely on these arrangements as an alternative to vacating their sites altogether. Our assessment against this relevant objective has therefore been more theoretical than we would have ideally liked and, as noted above, this is something the GDNs will need to consider if they wish to propose an enduring modification along these lines.

On the basis of the above we consider that on the balance the proposed modification would better facilitate relevant objective (a).

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

We note that NG and other respondents considered that if GDNs have a more accurate view of users' capacity requirements on their networks, they will be able to provide the NTS with more accurate demand forecasts and capacity bookings. This was argued to be more cost reflective and therefore better facilitate relevant objective (d). Whilst we recognise these arguments we understand NTS exit capacity is booked some time in advance by GDNs. We also recognise there are other ways GDNs can obtain an accurate view of required capacity through demand forecasts. We are therefore unconvinced this will have a material impact on GDN's view of gas requirements on their networks. We therefore consider that this proposal will have little or no impact upon relevant objective d).

Assessment against Authority's primary duty to protect the interests of consumers

We have also considered whether the proposed modification is compatible with our primary duty to protect the interests of consumers. We have given this careful consideration, weighing up two factors. First, if these arrangements result in DM customers booking less capacity than under the current arrangements, the costs of the underutilised capacity will be recovered from the remainder of the customer base, including domestic and other NDM customers. Second, without these new arrangements there is a higher risk that certain DM users may cease to use the network leading to loss of relevant transportation revenue in the longer term and a more enduring increase to the costs carried by the remaining customers. As set out below, we have attempted to estimate what the impact on the charges to remaining customers might be if some DM customers make use of the new flexible arrangements, and have compared this with the impact on charges if a proportion of DM customers disconnect permanently from the network.

As noted above, NG provided information that shows that 24 per cent of its DM customers (or 158 of 663 sites) have reduced their SOQ to a level below their BSSOQ[11]. Under the worst case assumption that all of these customers would, if they were able, reduce their SOQ by 90% (for one year), NG estimated there would be a reduction of £7.2m in LDZ capacity charge revenues from these customers.[12]

The reduction in capacity charges from these DM customers would need to be recovered from all users resulting on average in an increase in annual transportation charge for Small Supply Points of 70p (based on annual average bill of £116) while Large Supply Points would see on average an increase of £240 (based on average annual bill £40,000). Under UNC 275 this increase in transportation charges would only apply for a limited period (until 1st October 2011). This analysis indicates that per customer the impacts of the more flexible arrangements are likely to be relatively small – or around 0.6 per cent increase in transportation charges in this worst case example.

Alternatively, if any more than a very small proportion of these 158 sites were to cease their use of the network altogether in order to cease paying capacity changes, the impact on transportation charges to all customers is likely to be much larger. This is because customers would need to carry the cost of underutilised assets for their remaining life which can be up to 45 years.

Given this logic, consumers will be better off in the long term by providing more flexible arrangements in the short term if this assists even a very small proportion of DM sites availing themselves of the more flexible arrangements to remain connected to the network. On this basis, we consider that the proposal is consistent with our primary duty to protect the interests of consumers.

Conclusion

We recognise the issue this proposal seeks to address is unique as it is a direct consequence of a severe economic downturn-the consequences of which are not accounted for within the current regulatory framework. We also recognise that the

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[11] This analysis was conducted on the basis of information provided by one of the sippers in the NG'sd area.

[12] The value of £7.2m is calculated on the assumption that the 158 customers who will reduce their SOQ to their BSSOQ have capacity equal to the average of all NG customers (451,522 kWh)

current capacity booking arrangements already allow users to reduce their capacity reservations over time and that the proposal simply seeks to provide more flexibility in the shorter term.

For these reasons and the fact the modification is for a limited period we consider that on balance the proposal better facilitates relevant objectives a) of the UNC and our primary duty to protect consumers. This is given the potential trade offs between the short term and long term increase in gas distribution transportation charges, while not directly impacting on the rest of the relevant objectives. We expect that shippers will facilitate the effective operation of this modification in a timely manner.

We note, however, that further work is proposed to develop an enduring modification with permanent changes to the UNC. In light of this, we expect that the industry will undertake more comprehensive analysis on the likely impact of any changes not only on those customers affected, but also on other customers' charges. We would expect that the analysis submitted with any further modification proposals would demonstrate that any enduring changes would not lead to inappropriate increase in the overall share of costs that are recovered from the rest of the GDNs' customer base.

We encourage industry as part of their development of enduring solution to reconsider whether the current capacity commitments placed on users are adequate in light of the UNC objectives. At the same time, we would encourage the industry to examine whether there are any benefits to aligning the reservation of network capacity by customers with GDNs' reservation of capacity on the NTS. Consistencies in this area may increase the efficiency of capacity bookings.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority, hereby directs that modification proposal UNC 275: Reduction in DM LDZ Exit Capacity for Supply Points with Significant Changes in Usage be made.

Rachel Fletcher,
Partner, Distribution

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