

Modification proposal:	<b>Uniform Network Code (UNC) 374: Interruptible to Firm – Supply Point Transition (UNC374)</b>		
Decision:	The Authority <sup>1</sup> has decided to reject this proposal		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	23 Sept 2011	Implementation Date:	N/A

## Background to the modification proposal

On 15 March 2007 the Authority directed the implementation of UNC modification 090: 'Revised DN Interruption Arrangements'<sup>2</sup>; this was subsequently implemented on 1 April 2008. The effect of this modification was to remove the automatic classification of sites with an Annual Quantity ('AQ') of consumption above 5,860,000 kWh as being eligible to be designated as an Interruptible Supply Point by the Gas Distribution Network operators ('GDNs'). Instead, the GDN would determine the amount and location of interruptible capacity that it may require in order to operate the network efficiently and invite consumers, through their shippers, to offer interruption on their preferred terms.

The change in arrangements ensures that GDNs only offer interruptible contracts where there is a network capacity constraint, and therefore an associated benefit to wider customers from the avoided investment cost. In addition, the new arrangements allocate interruptible contracts to the customers who require the lowest level of compensation to be interrupted through a competitive auction process. This contrasts with the previous regime whereby all sites above the interruptible threshold could be designated as interruptible and exempt from the capacity element of transportation charges, irrespective of the likelihood or actuality of them ever being interrupted.

Whilst all formerly interruptible Supply Points have had the ability to be re-designated as Firm sites, from 1 October 2011 this status will apply to all sites which have not entered into a separate interruption arrangement with the relevant GDN. Thereafter, those former interruptible sites will be subject to the same regime as existing Firm sites, including the usual capacity charges and other elements such as exposure to ratchet charges.

Ratchet charges provide incentives for shippers to book sufficient supply point offtake quantity ('SOQ') for each of their Daily Metered ('DM') supply points and to ensure that the network operator has made sufficient capacity available to those sites to meet demand in peak flow conditions. In the event that the amount off-taken by a DM supply point exceeds the SOQ during the winter period, i.e. 1 October to 31 May, shippers incur a supply point ratchet charge for the quantity of gas that exceeds the SOQ.

## The modification proposal

This modification seeks to give those sites which are transitioning from an Interruptible to Firm classification a 'soft landing' in terms of continuing the exemption from ratchet charges for a further year. In order to minimise the impact on systems, it is proposed that ratchet charges are in fact applied, wherever appropriate, but that they are

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

<sup>2</sup> See: [www.ofgem.gov.uk/LICENSING/GASCODES/UNC/MODS/Documents1/UNC090D.pdf](http://www.ofgem.gov.uk/LICENSING/GASCODES/UNC/MODS/Documents1/UNC090D.pdf)

subsequently reimbursed in respect of sites which have changed from Interruptible to Firm status between 1 April 2011 and 31 May 2012, for charges applicable from 1 October 2011 to 31 May 2012.

### **UNC Modification Panel recommendation**

The UNC Modification Panel considered UNC374 at its meeting of 18 August 2011. The Panel determined by 9 votes to 2 to recommend that UNC374 be rejected.

### **The Authority's decision**

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 18 August 2011. 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<sup>3</sup>.

The Authority has concluded that implementation of the modification proposal will not better facilitate the achievement of the relevant objectives of the UNC<sup>4</sup>.

### **Reasons for the Authority's decision**

We note that the responses to the Joint Office consultation on UNC374 were mixed, with 4 respondents being in support of the proposal, 4 opposed and the remaining response offering comments only. Those respondents who were in favour of UNC374 agreed with the proposer that it would provide a soft landing for those consumers who are transitioning from being an Interruptible to a Firm site, and therefore subject to ratchet charges for the first time. However, we agree with those respondents who point out that this change has already been subject to a soft landing insofar as it was signalled in our decision of 15 March 2007. Since that time, shippers have had opportunity to raise awareness of these changes and within the consultation responses there were several references to the efforts that have been made to date. Various links to the relevant objectives were made to support these conflicting arguments.

We have considered whether the further period of grace set out in this proposal would better facilitate the relevant objectives of the UNC. We have provided views against each of the relevant objectives cited in the proposal or responses, namely objectives b, c and d. We do not consider there to be any impact upon the other relevant objectives.

*Relevant Objective (b) - so far as is consistent with sub paragraph (a), the co-ordinated, efficient and economic operation of the combined pipe-line system of one or more other relevant gas transporters;*

One respondent suggested that UNC374 would further facilitate relevant objective b) as it will encourage consumers to state their true belief of their capacity without artificially inflating it in order to avoid possible ratchet charges. Conversely, while not directly linking their comments to relevant objective b), other respondents suggested that the removal of exposure to the ratchet charge would undermine the existing incentive on shippers and their customers to ensure that capacity requirements are accurately maintained. Some went on to suggest that shippers should focus on ensuring that

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<sup>3</sup> UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at [www.gasgovernance.com](http://www.gasgovernance.com)

<sup>4</sup> As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: <http://epr.ofgem.gov.uk/index.php?pk=folder590301>

customers' stated SOQ values were as accurate as possible as the appropriate means to mitigate any potential ratchet charges.

We do not consider that absence of further transitional arrangements as set out in this proposal is likely to lead to an inflation of SOQ in order to avoid the potential for ratchet charges as such an action would also increase the shipper's and subsequently the consumer's exposure to capacity charges. As acknowledged in responses, these sites are also under an existing obligation to submit accurate information and it is through working effectively with their shipper that those customers will be able to obtain an appropriate amount of capacity while mitigating any risk of ratchet charges.

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

Whilst all of those who were in support of UNC374 considered that it would ensure the efficient discharge of the licensees' obligations, none of them specified which licence obligation(s). Several of the other respondents, including three of the GDNs, were also unable to identify which, if any, licence obligation this modification would discharge. One respondent specifically stated that they are aware of no obligation on GDNs to provide soft landings for customers during a transition. We note that the UNC Modification Panel was also unable to identify any licence obligation to which UNC374 could relate and was therefore unable to reach a view on whether its implementation would further facilitate relevant objective c).

Whilst we understand the proposer's aim of facilitating a soft landing for those customers who may be faced with the requirements of the ratchet regime for the first time, we have not been able to identify any obligation under the Gas Transporters Licence which would require it. To the extent this modification would require the GT to apply a different treatment for shippers at a newly Firm supply point as opposed to an existing Firm site, it could be argued that it would actually impinge upon the GTs obligations under Standard Licence Condition 4D: 'Conduct of Transportation Business'.

We note that the proposer and some of the respondents considered that a precedent for such a soft landing has been created with the implementation of UNC224: 'DM elective'<sup>5</sup>. However, we agree with the respondent who pointed out that while interruptible sites may be exempt from ratchet charges, they should already be submitting accurate SOQs. Therefore, unlike the transition from Non-Daily Metered to Daily Metered (Elective) status, no additional burden is being placed upon the customer or their shipper; they are simply being exposed to the financial consequences of failing to comply with existing requirements. We also consider that there is a significant difference between the treatment of an individual site which elects to enter into the DM regime for the first time, and a universal change that has been signalled to the market more than four years in advance.

Relevant Objective (d) - *so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition between relevant shippers/suppliers;*

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<sup>5</sup> The effect of this modification was to allow sites which have consumption below the normal Daily Metered threshold of 58,600,000kWh to elect to be included within the Daily Metering regime if they have an advanced meter fitted. This would facilitate those sites to be balanced and settled on the basis of daily reads rather than the prevailing Non-Daily Metered profile. For further details see: [www.ofgem.gov.uk/LICENSING/GASCODES/UNC/MODS/Documents1/UNC224D.pdf](http://www.ofgem.gov.uk/LICENSING/GASCODES/UNC/MODS/Documents1/UNC224D.pdf)

Whilst neither the proposal nor the work group report make any reference to relevant objective d), both indirectly refer to the impacts that the application of the ratchet regime may have on competition and this was considered further by the UNC Modification Panel. Some members commented that the implementation would facilitate competition insofar as it would allow consumers who were previously interruptible and not experienced in the operation of the firm market the opportunity to establish appropriate SOQs without the risk of facing ratchet charges. However, they did not elaborate on how this would, of itself, further effective competition between shippers, suppliers or GDNs.

The proposer argues that as there is increased switching activity around 1 October each year, there will be a constrained window for the new supplier to query and change the SOQ to reflect the customers' actual requirements. They considered that this could deter some customers from switching. Some Panel Members did share the proposer's concern that an acquiring shipper may not have a sufficient time to access and assess customer's historic information. However, they held opposing views on whether this would benefit or distort competition.

Some respondents and Panel Members felt that shippers and consumers alike have had adequate time to manage the transition from interruptible to firm status. Some suggested that the peak daily load should be obtained from the customer at some point during the supply point acquisition and is therefore no different from an existing Firm DM site changing supplier.

We do not consider that this modification would have any material benefits to competition between shippers and/or suppliers and agree with those respondents who suggested that it would in fact negate the efforts of those shippers who have proactively and effectively engaged with their existing and potential customers to obtain an accurate SOQ.

We also note that UNC ratchet charges are in fact levied upon shippers and the extent to which they are passed through to customers is a contractual matter between customers and their shipper. It is likely that a customer's acceptance of any ratchet charge being passed through may depend on the extent to which they were made aware of such charges in the first place and the steps the shipper took to negate that exposure. We therefore disagree with those respondents who suggested that UNC374 would be beneficial in removing a potential impediment to a DM customer switching supplier this winter. To the extent that the customer is aware of ratchet charges and they play a part in their choice of supplier, we consider it will be an additional opportunity for shippers/suppliers to differentiate themselves. The removal of this point of differentiation may therefore be marginally detrimental to competition, albeit the effect would be limited to the soft landing period set out in the proposal.

## **Decision notice**

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority hereby directs that modification proposal UNC374: '*Interruptible to Firm – Supply Point Transition*' be rejected.

**Rachel Fletcher**  
**Acting Senior Partner, SG&G - Distribution**

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