Making a positive difference
for energy consumers

Modification proposal:	**Uniform Network Code (UNC) 445: Amendment to the arrangements for Daily Metered Supply Point Capacity**		
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:	26 March 2015	Implementation Date:	Project Nexus Implementation Date[3]

Background

Within the current rules of the UNC, if a Daily Metered (DM) user wishes to reduce the amount of gas it takes off the system and have its charges adjusted accordingly, it is limited in its ability to do so. The current system does not allow customers to respond in a timely manner to changing patterns of energy usage and the existing rules can result in them paying charges for capacity which does not reflect their (lower) use of the gas network.

DM customers can only change their gas capacity booking ('Supply Point Offtake Quantity' (SOQ)) requirements in a specified time period, once a year between October and January (Capacity Reduction Period). The SOQ must also not be less than the Bottom Stop Supply Point Offtake Quantity (BSSOQ). The BSSOQ is fixed and based upon the peak day consumption within a winter period (October to May inclusive). This value is then effective from 1 October at the start of the next winter period. Therefore, whilst the SOQ can be amended annually, it must not be less than the BSSOQ, which will always be pegged to the previous winter's peak day consumption.

The industry considers this system to be outmoded. In periods of economic downturn, businesses may change their profile, and therefore reduce energy usage considerably in the period of a year. This could have significant financial implications for customers' charges if they are unable to book capacity which reflects their anticipated future demands.

Over the last three years this issue has been addressed by three time-limited modifications (UNC275[4], UNC405[5] and UNC478[6]) which allowed amendments to the User's Supply Point Capacity holdings in certain circumstances. These were implemented on a transitional basis. In our decision letter for UNC405[7] we said we expected Gas Distribution Networks (GDNs) to develop an enduring modification with permanent changes to the UNC. We were disappointed that it was necessary to extend the earlier interim solution.

[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] Project Nexus is Xoserve's project to replace key IT systems which support the competitive gas market. The current proposed implementation date is 1 October 2015. A further modification (UNC478) to bring transitional rules into the UNC has been raised which could ensure that benefits of this modification are not lost to the 2014-15 capacity booking period.
[4] http://www.gasgovernance.co.uk/0275
[5] http://www.gasgovernance.co.uk/0405
[6] http://www.gasgovernance.co.uk/0478
[7] http://www.gasgovernance.co.uk/sites/default/files/UNC405D.pdf

The modification proposal

UNC445 was raised by National Grid Gas Distribution ("the proposer") on 25 July 2013. The aim of this modification is to introduce an enduring solution to allow DM customers to reset their capacity bookings, irrespective of the previous gas year's consumption. This will be done by removing the need to calculate and record the BSSOQ within the Supply Point Register. By doing so the proposer considers that DM Customers should be able to book capacity which reflects actual use better.

The proposer considers that customers will be better able to respond to challenges in the current economic climate by making timely changes to their patterns of energy usage.

The modification proposes the following changes -

- Removing the BSSOQ limit from Supply Point Capacity bookings.
- The new Supply Point Capacity booking would be limited to a value not less than the maximum daily consumption recorded in the Winter Period concurrent to the Capacity Reduction Window in which the reduction is to take effect.
- When aggregating or disaggregating a Supply Point (to take effect outside the capacity Reduction Window), ensuring that the total DM Supply Point Capacity of all the proposed Supply Points must be equal to, or greater than the total DM Supply Point Capacity of all the Current Supply Points.
- Introducing a Capacity Reconciliation Charge (CRC) to discourage 'capacity profiling', where a User could make a financial gain by booking a lower amount at the start of the Gas Year and increasing it to account for higher daily consumptions when they occur in the colder winter months.
  - A CRC would be levied each time a User requests, and is granted, a voluntary increase to its capacity booking, where in the same Gas Year that User has previously effected a decrease.
  - The CRC would be paid by the requesting User and would be calculated using a formula set out in the UNC. This formula would include an 'incentive factor' which would initially be set at 1. Users' capacity booking behaviour would be reviewed in the normal course of business, to assess whether they were attempting to take advantage of the opportunity to do capacity profiling. If there is evidence of such behaviour, the incentive factor could be increased in a future modification to a value greater than 1 to ensure that any such behaviour incurred a financial penalty.
  - A CRC would not be payable where no decrease was effected in the Gas Year, or in respect of capacity booked in excess of the amount booked immediately prior to the first decrease.

The proposer considers the modification will better facilitate relevant objectives (a) and (d) of the UNC[8] as it will allow customers adjust their capacity bookings to reflect their real needs and the market as a whole to operate more effectively and competitively. Whilst this may result in an under use of capacity, with the associated costs being recovered from all other customers, the proposer considers that these costs would be much less significant than if a customer were to leave the market, creating unused capacity, because a capacity reduction was not available.

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[8] As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: https://epr.ofgem.gov.uk//Content/Documents/Standard%20Special%20Condition%20-%20PART%20A%20Consolidated%20-%20Current%20Version.pdf.

By enabling the customer effectively to reduce their Supply Point Capacity to match intended use, appropriate charges can be levied. The proposer considers that this offers stability in charges to aid effective competition between relevant shippers and suppliers. The proposer also considers that more accurate capacity booking should avoid potential sterilisation of capacity.

UNC Panel[9] recommendation

On 21 August 2014 the Panel unanimously voted to approve UNC445.[10] In our direction of 20 November 2014,[11] we said we wanted the industry to provide more analysis on the likely impact the proposed changes would have on the customers directly affected as well as on other customers' charges.[12]

On 19 February 2015, the UNC Panel voted unanimously to recommend return of UNC445 to Ofgem and submitted the revised Final Modification Report[13] (FMR) to us on 19 February 2015. The FMR was accompanied by a report with analysis of the likely impact the proposed changes would have on the customers affected as well as on other customers' charges.

Our decision

We have considered the issues raised by the modification proposal and the FMR of 19 February 2015. We have considered and taken into account the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR.[14] We have concluded that:

1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC;[15] and
2. directing that the modification be made is consistent with our principal objective and statutory duties.[16]

Reasons for our decision

We acknowledge the potential problem faced by customers as a result of the current economic climate and welcome the proposal of an enduring solution to this issue.

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

[10] http://www.gasgovernance.co.uk/sites/default/files/Final%20Modification%20Report%200445%20v2.0_0.pdf

[11] http://www.gasgovernance.co.uk/sites/default/files/Ofgem%20Letter%20Send%20Back%200445%20Request%20for%20info.pdf

[12] Prior to this, on 24 September 2014 we directed the FMR to be revised and resubmitted as we considered that the proposed legal text was inconsistent with the outcome intended by the modification proposal. The UNC Panel resubmitted the revised FMR on 16 October 2014.

[13] http://www.gasgovernance.co.uk/sites/default/files/Final%20Modification%20Report%200445%20v2.0_0.pdf

[14] UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com.

[15] As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: https://epr.ofgem.gov.uk//Content/Documents/Standard%20Special%20Condition%20-%20PART%20A%20Consolidated%20-%20Current%20Version.pdf

[16] 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.

We have assessed the modification against the UNC Relevant Objectives. We note that all seven respondents to the Joint Office's consultation supported this modification. We agree with the proposer, the UNC panel and the majority of respondents who commented that the modification proposal better facilitates the achievement of relevant objectives (a) and (d). We also agree with National Grid Gas Distribution that this modification better facilitates relevant objective (b). We consider that it is neutral in relation to the other Relevant Objectives.

(a) Efficient and economic operation of the pipe-line system

The current economic climate may require some customers to respond by changing their pattern of energy use. In some cases where businesses have closed and others have opened, a change in energy consumption at that supply point may be inevitable. Continuing to apply the BSSOQ would prevent customers from reducing their capacity booking to reflect changes to their usage, which could lead to unsustainable charges and an inefficient network that could be sterilised by unrealistic capacity bookings.

Whilst we recognise that the analysis of the transitional modifications did not provide any evidence to suggest that such capacity had been released to date, this could be due to the limited take-up of the mechanism. We therefore understand that the future application of this modification could enable customers to reduce their booking to reflect changes to their usage. This could contribute to a more efficient and economic operation of the pipe-line system.

A more accurate reflection of future demand at supply points will have a positive impact on forecasts of overall network demand and could therefore reduce the need for anticipated reinforcement in order to accommodate new connections. This would facilitate the efficient and economic operation of the system.

(b) Co-ordinated, efficient and economic operation of (i) the combined pipe-line system, and/or (ii) the pipe-line system of one or more relevant transporters

We consider that allowing customers to book capacity for the Gas Year which reflects their anticipated demand over that year allows a more efficient allocation of capacity and, therefore, a more accurate forecast of total network capacity requirements. Shippers will be able to reset more accurately their capacity requirements annually, ensuring that transportation charges reflect system usage better. As a result of this, we consider that transporters will have access to more accurate usage information and this will contribute to a more efficient and economic operation across the whole system.

(d) the securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators and relevant shippers

A more efficient and accurate forecast of Supply Point capacity, without restriction to the previous year's peak capacity, will allow both shippers and suppliers to forecast more accurately their requirements and costs. We consider that by recognising customers' real needs, the market as a whole will operate in a more effective and competitive way.

We agree with the six respondents that considered this modification better facilitates this objective. We consider that it will allow shippers to book capacity which reflects demand more accurately. This will ensure that more appropriate charges are levied to shippers and customers facilitating more effective competition between shippers.

Other comments

To better understand the supplemental analysis accompanying the FMR of 19 February 2015, we requested and received background workings. The supplemental report and accompanying workings demonstrate that the historical use of the capacity reduction product set out in the time limited modifications (275, 405, 478) had negligible impact on Local Distribution Zone (LDZ) Transportation charges based on the capacity reduction requests enacted.

In the event that take-up would increase with the introduction of an enduring solution, National Grid Gas Distribution provided additional scenario analysis for its LDZs, based on a proposed increase in take-up of capacity reductions. These scenarios examined how distribution charges would be affected if capacity reductions were (i) doubled, (ii) increased ten times, and (iii) increased 100 times, compared to the reductions that had taken place during the transitional modifications. We are reassured that if the take-up were to increase by 100 times, it would only affect two LDZs' Transportation charges, and even in these cases, at very minimal levels.

We note that there was a typographical error in the final paragraph of page six of the FMR. This was identified in the FMR submitted on 16 October 2014 and remains in the FMR submitted on the 19 February 2015. It states the policy intent that a CRC would be levied each time a User requests (and is granted), a voluntary increase in its capacity booking, where in the same Gas Year that User, or any other User, had previously effected a decrease. We understand that the inclusion of the words "or any other User" is an error as it contradicts the corresponding legal text which is drafted on the basis that the decreases and increases in bookings are specific to an individual User. It also contradicts other policy statements in the FMR indicating that the CRC is aimed at the behaviour of individual Users. We do not believe this to be a material error in the FMR, and it does not affect the modification as the legal drafting correctly reflects the policy intent. This had been confirmed by the proposer.

We also note that in the legal text amendments to paragraph 5.2.1(a), after the words '<u>any previous Gas Day</u>', the words '<u>within the Winter Period</u>' have been inserted. The discrepancy in dates appears to have the effect of allowing Registered DM Supply Point Capacity to be unrestricted during the month of October in any given year. However, we note that the possibility of a CRC payment may act as a disincentive for capacity profiling during this period.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority directs that modification proposal UNC445: 'Amendment to the arrangements for Daily Metered Supply Point Capacity' be made.

Andy Burgess
Associate Partner, Transmission and Distribution Policy
Signed on behalf of the Authority and authorised for that purpose.