

## Representation - Draft Modification Report 0571/0571A

### Application of Ratchet Charges to Class 1 Supply Points (and Class 2 with an AQ above 73,200kWhs)

Responses invited by: **5pm 24 January 2017**

To: [enquiries@gasgovernance.co.uk](mailto:enquiries@gasgovernance.co.uk)

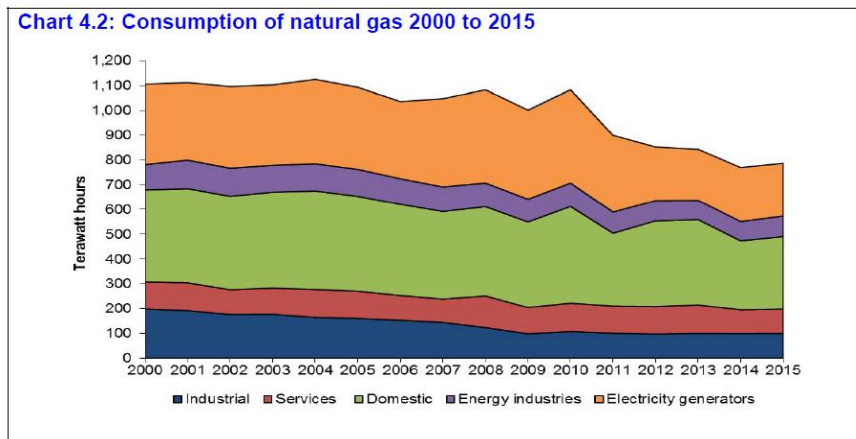
<b>Representative:</b>	Steve Mulinganie
<b>Organisation:</b>	Gazprom Energy
<b>Date of Representation:</b>	24 January 2017
<b>Support or oppose implementation?</b>	<b>0571</b> - Support <b>0571A</b> - Oppose
<b>Alternate preference:</b>	<i>If either 0571 or 0571A were to be implemented, which would be your preference?</i> <b>0571</b>
<b>Relevant Objectives:</b>	a) Positive d) Positive f) Positive

#### Reason for support/opposition: Please summarise (in one paragraph) the key reason(s)

1.1 The original purpose of the penal ratchet charges was first conceived at privatisation (more than 20 years ago) and was to ensure that shippers provided accurate information to transporters regarding the peak demand requirements for very large industrial loads, whose offtake in a constrained system may have caused issues with the network management if they exceeded their registered peak requirements.

1.2 This concern may have been understandable for a small number of large commercial sites located at possible pinch points in the network, as well as for the very largest industrial loads, at a time where there was far less capacity on the networks available than there is now since peak gas demand has declined (see 1.3 below). However it is also important to note the application of these penalty charges are retrospective i.e. the application always occurs after the event so the charge in itself does not physically stop the event occurring and Networks have other tools to manage the real-time risk, if any, of such an occurrence.

1.3 As can be seen by the chart below since 2000 the long term trend for overall consumption of gas has reduced which in part is due to the continuing drive for energy efficiency and the changing role of gas in the overall energy mix. This means the existing networks which were largely designed to support higher historic demand is now largely unconstrained. This is further evidenced by the removal of capacity management tools from the UNC such as Interruptible Services and the ability for Networks to be able to deem sites as Network Sensitive Loads (NSL's)



1.4 As noted above the market has substantially changed in the last 20 years and will do so further through the changes being introduced by Project Nexus such as: -

- Introducing individual meter point reconciliation
- Allow all customers the potential to access daily settlement services
- Introduction of 4 new customer classes

In addition, the mandatory rollout of advanced and smart metering provide cost effective remote access to more granular consumption data

We believe the ability to optimise these new arrangements should not be materially affected by a legacy penal ratchet charge regime

1.5 We would also note the recent publication of the Competition Markets Authority (CMA) final proposals which clearly signpost a desire to move towards more granular data & settlement services. To support this principle Gazprom Energy have raised review group proposal 0594R - Meter Reading Submission for Advanced & Smart Metering to a suitable glide path for utilising more granular levels of settlement.

1.6 Since the advent of the penal ratchet charge regime there has been a steady drop in the number of daily read sites; from **tens of thousands to hundreds**. Despite this substantial reduction in the number of sites setting their own SOQ the gas transporters have never indicated any concern that most large industrial sites are not daily metered and instead rely on an estimation algorithm to determine peak daily demand.

1.7 We are therefore unconvinced by the concerns raised by gas transporters that this change to the penal ratchet charge will materially impinge on their ability to manage their networks. We note that transporters have real-time access to pressure monitoring which is the primary tool for balancing the network and that the metering, services and network design (including the local Governor settings) provide inherent degrees of protection from physical over utilisation. Finally network operators also have ultimate powers to physically intervene to limit offtake should if the network is put at risk.

1.8 We would have expected some form of remedy to have been brought forward by now if these concerns had any merit. We also note that the proposed remedy leaves the Ratchet regime in place thus ensuring that any under booking of SOQ is immediately corrected by the SOQ being ratcheted up.

1.9 Highlighting the unconstrained nature of capacity on the networks we also note the removal in recent years of the interruptible regime and ability for gas transporters to nominate sites as Network Sensitive Loads (and so be daily metered and have their peak consumption set) has been discontinued. There will therefore be no mechanism for a site's peak consumption to be explicitly set if it does not choose to become daily metered and it may be either daily or non-daily metered as the shipper or customer determines.

1.10 Crucially the site's consumption profiles will not depend on how regularly the site is settled and there seems no logic to have one site, which is Product Class 2 to be subject to the penal ratchet penalty charge, when an identical site is not. With the ratchet itself still in place and the network unconstrained why should an identical customer in Class 2 be subject to a penal Ratchet Charge in the winter when a customer in Class 3 is not and yet they can both have the same effect if they increase consumption due to unseasonably cold weather?

1.11 There is also no logic or justification for the clear discrimination introduced in the arbitrary dividing line which UNC Modification 0571A proposes; why would a customer with an AQ of 72,000 kWh not be a threat to the network's operation, but one with an AQ of 74,000kWh is?

1.12 Instead of compromising the ability for transporters to accurately manage their networks, UNC Modification 0571 will in fact improve it by removing any unnecessary penal Ratchet Charges for utilising more granular settlement services. The ultimate aim for network management is that customers provide accurate SOQs. The current daily read ratchet charge regime actively encourages over-estimation of peak system needs as shippers and consumers have to err on the side of caution to avoid these penalty charges. This has the impact of sterilising capacity and results in an inflated view of peak gas requirements and so leads to inefficient investment in unnecessary additional network capacity.

1.12 This is currently a problem with existing DMV sites; with the removal of restrictions on which sites can be daily read, we expect a substantial increase in the number of daily read sites that suppliers operate. This will result in a corresponding increase in the amount of over-estimated SOQ and so will increase the cost of funding unnecessary peak capacity capability to all customers.

1.13 We note that UNC Modification 0571A by unreasonably narrowing the scope of its change to the smallest customers will remove the benefit of improving SOQ accuracy from those sites that are most likely to benefit from it.

1.14 With the rollout of advanced and smart metering it is estimated that the gas and power markets will gain around £16.7bn in benefits, of which £839m is network benefits from *“better information on patterns of use across networks will aid network planning and development”*<sup>1</sup>. A substantial portion of these benefits can only occur and be realised if there are no penal barriers to customers becoming daily settled, so allowing the increased granularity of site consumption to flow through to settlement, improving cost allocation and reducing settlement risk.

1.15 With the removal of technology and system restrictions and the new classes created via Project Nexus, the penal nature of the ratchet charge regime is the only substantial barrier to any site with a Smart or AMR device to become daily read. The penal cost of the ratchet would wipe out any margin and make the risk profile associated unattractive e.g. the exposure to temperature sensitivity on sites with heating loads would in particular be difficult to determine. It should be noted that historically the split between heating plant being the primary use of gas on site, and process loads, was circa 10,000 therms (298,000 kWh) which is significantly higher than the threshold proposed in 0571A.

1.16 As noted customers with operations which are more weather sensitive e.g. a higher proportion of consumption is associated with heating, would be more likely to be exposed to penal ratchet charges than less weather sensitive process loads. During the winter the impact of potential cold spells would expose these customers to penal ratchets unless those customers substantially overestimate their SOQ's to factor in this occasional risk. As noted this risk is not exclusive to domestic customers as lots of smaller non domestic sites will use gas for heating e.g. schools, care homes etc.

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<sup>1</sup> BEIS document, SMART METER ROLLOUT COST-BENEFIT ANALYSIS, November 2016

1.17 UNC Modification 0571 removes this penal ratchet charge and in doing so removes a potential significant barrier to the utilisation of more granular settlement classes. The benefits from daily read sites is scalable; the larger the site's annual consumption, the larger the benefit from improved accuracy. The more consumption that is settled under Class 1 & 2 the greater the reduction in volatility associated with the smearing factors which are used to manage unallocated consumption i.e. the period for which consumption is incorrectly allocated via smearing will reduce as correct information will be available more quickly i.e. daily versus monthly, six monthly, annually etc. This increased certainty will aid more accurate cost allocation and reduce risk premiums in the market.

1.18 UNC Modification 0571A, by significantly limiting the number of customers who can benefit from this change, significantly reduces the benefits of changing the current regime to the point where we believe it is negligible in the short to medium term as the number of these sites with Advanced or Smart Metering fitted and able to benefit is far smaller in proportion to the rest of the market were Advanced and Smart are more prevalent.

**Self-Governance Statement:** *Please provide your views on the self-governance statement.*

Gazprom Energy agrees that in both cases these modifications should not be considered suitable for self-governance as they will have a material impact on the commercial arrangements between customers and suppliers (and by extension shippers).

**Implementation:** *What lead-time do you wish to see prior to implementation and why?*

This modification will need to be implemented at the same time as Project Nexus to avoid delaying the rollout of daily read status to those customers who can benefit. Considering the straightforward nature of the solution, which does not require a system change to deliver, we see no reason why these changes cannot be delivered in good time.

**Impacts and Costs:** *What analysis, development and ongoing costs would you face?*

UNC Modification 0571 will result in substantial saving for customers as it will firstly reduce the administrative burden of calculating SOQs for large numbers of sites as they move towards daily read status, and secondly remove the need to continually appeal sites that breach them. It will also remove a significant barrier to sites becoming daily read, so ensuring that the benefits of more frequent settlement for customers are captured. This will reduce risk in the market by improving cost allocation and so benefit customers.

UNC Modification 0571A, restricting its benefits to the smallest sites in the market will only deliver the fraction of the benefits set out above to the point where those benefits will be negligible.

**Legal Text:** *Are you satisfied that the legal text will deliver the intent of the Solutions?*

We have reviewed the legal text and believe it meets the requirements for both modifications.

**Modification Panel Members have requested that the following question is addressed:**

**Q: Respondents are asked to provide views on who they believe should fund the central implementation costs.**

Both changes simply require that the transporter's agent does not seek to invoice the shipper for a site that has ratcheted – all other aspects of the ratchet regime are unchanged. The work to not invoice customers when ratchets occur is minor as we understand that these invoices already have an element of manual intervention; both modifications simply seek to change the reasons for when an invoice is suppressed, not add or remove any processes currently undertaken by Xoserve.

We do not agree that a systemised solution is necessary, but if the gas transporters wish to automate the process then would expect an overall cost saving to them and so any form of User Pays adjustment should be a credit to shippers.

**Are there any errors or omissions in this Modification Report that you think should be taken into account?** *Include details of any impacts/costs to your organisation that are directly related to this.*

No

**Please provide below any additional analysis or information to support your representation**

N/A