

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

Representative:	Hilary Chapman
Organisation:	SGN
Date of Representation:	24 th January 2017
Support or oppose implementation?	0571 - Oppose 0571A – Oppose
Alternate preference:	<i>If either 0571 or 0571A were to be implemented, which would be your preference?</i> 0571A
Relevant Objectives:	a) Negative d) None f) Negative

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

SGN considers the application of the ratchets regime, including the associated charges, to Project Nexus class 1 and 2 sites, to be appropriate and proportionate.

We do not consider that any evidence has been presented to demonstrate a material change in industry circumstances which justifies the restriction of an existing regime.

We do not consider that either Modification furthers the relevant objectives identified.

We have provided the following observations to support our view:

Requirement and Purpose of the Ratchets Regime

In Ofgem's Decision Letter published 21st March 2016 rejecting a very similar proposal - UNC Modification 0551¹ - OFGEM stated that an exemption from ratchet charges "*would not incentivise shippers to set their SOQ to their use when demand is at its highest and could result in network operators not making sufficient capacity available to meet demand in peak flow conditions.*"

The latter point "*making sufficient capacity available to meet demand in peak flow conditions*", is a requirement under Standard Condition A16 of the Gas Transporters Licence – commonly referred to as the '1 in 20 test'. This test was formulated in consultation with the Health and Safety Executive and represents the standard to which we construct, maintain and operate our network with regard to the security of the system and the reliability of supplies therein connected.

It should be noted that the existing methodology for satisfying this licence condition has been developed and applied on the basis of the ratchets regime being in place to its full extent. The restriction of the ratchet regime is likely to result in a significant change in network management methodology being taken going forwards.

Furthermore, the above reference demonstrates the intrinsic link between SOQs and network capacity; the former providing effective market signals to inform the latter. This market signal is especially important on single-fed lines such as those commonly seen on the Scottish distribution network.

On the Scottish distribution network we see a combination of lower offtake pressures, the absence of an integrated network and a growing concentration of large customers. This requires the close matching of SOQs and network capacity in order to maintain a network which is both stable and efficient - balancing the needs of customers with the associated costs of delivery, ensuring that consumers are not funding a network whose capacity is over- or under- delivered. By reducing the incentive on customers and Shippers to accurately forecast their SOQs, we are concerned that we may receive an increase in under-estimated SOQs. This would create inaccurate market signals, which risks undermining the safety and stability of the network.

Workgroup Discussions

We have articulated the above throughout the development workgroups, where the following issues have often be raised;

Increasing Gas Demand. Claims are often made that the national decline in gas consumption should equate to an unconstrained network. This is a generalised view which does not take into account geographically specific areas of the network where demand exceeds capacity. As an example, for most of the customers in Scotland, gas is the most economic fuel available, creating a strong commercial incentive to increase their gas consumption as far as it is made available to them.

¹ Ofgem, *Decision Letter 0551*, <http://www.gasgovernance.co.uk/sites/default/files/Ofgem%20Decision%20Letter%200551.pdf> [Retrieved: 19/01/16].

Secondly, an overall decrease in consumption does not equate to a smoothing of load profile, and therefore the necessity to carefully manage the risk associated with peak consumption persists.

Interruptible Supply Contracts are still required. Similarly, we refute the assertion that the removal of interruptible supply contracts is further evidence of an unconstrained network. The mechanism to offer interruptible contracts on a voluntary basis continues to exist, demonstrating the ongoing presence of constrained areas. In addition, and as below, in order to maximise network value and availability, we regularly allow otherwise constrained industrial customers to consume gas during the off-peak seasons as a result of UNC MOD 458 (Seasonal Capacity).

Ratchets are a regularly used incentive mechanism. Appendix 3 of the Draft Workgroup Report shows that approximately 10% of large customers incurred ratchet charges in the winter of 2015/16, demonstrating that accurate management of SOQs persists as a difficulty for many users and therefore that the regime is required to remain in place. Consider the analogous example of a stretch of road upon which 10% of drivers incur speeding tickets – it is unlikely that such a high proportion of endorsements would result in the restriction of speed cameras in situ.

Real-time monitoring does not replace good behaviour. Similar to speeding tickets, ratchets are applied retrospectively – this is the very nature of any regime which exists to deter certain behaviours and apply penalties should they occur. For some parts of our network it can take several hours for the gas to travel the length of the network to a given supply point. Real-time monitoring, whilst helping to swiftly identify an issue, will not prevent an on-the-day supply emergency caused by capacity being over-utilised on a constrained part of the network.

Implications on other customers – Safety and Security. The ratchets regime is the only incentive currently in place to encourage accurate management of SOQs. An unexpected increase in consumption by one consumer within a constrained area (which could arise from demand levels only marginally in excess of the reserved volume) would have significant implications on the security of supply for surrounding customers and would also have significant impacts upon the consequent safety of the network. The latter is of primary importance and the restriction of the ratchets regime would place unacceptable risk upon the safe operation of the networks.

Availability of Up-Stream Capacity. Furthermore, an unanticipated use of excess capacity, beyond that reserved, could cause the distribution network to require a short-notice increase in capacity from the associated LTS network, likely triggering a consequent request from the NTS network. The absence of any prior indication of capacity requirements, such as the management of appropriate SOQs, would result in such requests being outside of the required capacity forecasts, which could lead to such capacity being unavailable, or reinforcement being considered.

Enhancements in Granularity of Available data

We agree with the Competition and Markets Authority (CMA) assessment that enhanced availability and use of granular data will be of benefit to the industry, with both Smart and Project Nexus providing good opportunities to improve against the current position.

In relation to Nexus specifically, we welcome the four new settlement classes and the opportunity they offer in terms of access to Daily Metered arrangements, especially in the case of domestic Smart consumers.

However, we do not consider that the presence of the ratchets regime is an inhibitor to the use of any class and therefore to the provision of more granular data. Given the settlement benefits opportunities which the higher classes provide, including Shippers self-nominating their SOQs, we consider that the application of the ratchets regime is a fair balance, providing protection to the network organisations whom otherwise have little control of the nominated capacity values.

Furthermore, we suggest that the new settlement regime delivered by Project Nexus should be subject to a bedding-in period to establish some reliable performance trends, before an assessment of the success or otherwise of the classes, and therefore amendments to their design, are made.

Additional Capacity Management Procedures

SGN are committed to managing the network in an appropriate and efficient manner, and have raised and implemented several UNC modifications in this regard:

- 0458² – *Seasonal LDZ Capacity Rights* – facilitating seasonal access to capacity, benefitting consumers and avoiding unnecessary reinforcement costs;
- 0390³ – *Introduction of a Supply Point Offtake Review and Monitoring Process* – whereby we annually review forecast SOQs and proactively provide Shippers with recommendations for SOQ amendments based on actual usage.

The above processes demonstrate our drive for efficiency and proportionality of the capacity arrangements in place. It is therefore in full consideration of all factors that we cannot support any restriction of the ratchets regime.

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

We do not consider that these Modifications are self-governance as they have material impacts upon the safe and efficient operation of the network, and also upon the commercial arrangements between Transporters, Shippers and end consumers.

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

The implementation timescales of either Modification should take into account the relative industry priorities, and therefore should not cause the diversion of any resources from the delivery and post-implementation support of Project Nexus.

² <http://www.gasgovernance.co.uk/sites/default/files/Final%20Modification%20Report%200458%20v2.0.pdf>

³ <http://www.gasgovernance.co.uk/sites/default/files/Final%20Modification%20Report%200390%20v2.0.pdf>

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

Both Modifications will incur development costs in relation to the central systems, estimated by Xoserve to be in the range of £100k-£300k. There are also likely to be ongoing costs.

Implementation of either Modification is also likely to cause SGN to incur increased costs in respect of network analysis and monitoring, as well as potential reinforcement.

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

Yes

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.

The restriction of the ratchets regime is a new requirement and was not identified within the Project Nexus BRDs, and as such should not be funded by the Gas Transporters within the Project Nexus delivery costs.

As Shippers are the only UNC parties whom stand to benefit from this change, we consider that central implementation costs should be subject to User Pays arrangements, as per the draft ACS provided⁴. We note that given the post-FGO implementation timescales associated with either Modification, the new FGO-equivalent User Pays arrangements should be employed.

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.*

None.

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

Please find below a worked example to demonstrate the significant impact upon network pressure as a result of an incremental increase in consumption:

Base Case

Source (Offtake) set at 19.0bar outlet pressure

Demand of 2.068 mcmd with a 'normal' diurnal profile

Pipeline of 10.01km x 300mm (90% efficiency)

⁴ <http://www.gasgovernance.co.uk/0571/241116>

Peak (1900hrs) Hour Extremity Pressure = 3.52bar

Increase of 1.6% Demand (Daily)

Source (Offtake) set at 19.0bar outlet pressure

Demand of 2.101 mcmd with a 'normal' diurnal profile

Pipeline of 10.01km x 300mm (90% efficiency)

Peak (1900hrs) Hour Extremity Pressure = 1.96bar

The above demonstrates that even a small increase in demand can have a significant impact upon the network pressure, leading to potential security of supply and safety issues. Restriction of the ratchet regime would remove the only existing disincentive in place to discourage unplanned excessive consumption.