

Modification proposal:	Uniform Network Code (UNC) 405: Bottom Stop SOQ Appeal Mechanism for 2011/12 (UNC 405)		
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:	15 December 2011	Implementation Date:	To be confirmed by the Joint Office

Background to the modification proposal

Under the rules of the Uniform Network Code (UNC), customers may be categorised as Daily Metered (DM) or Non Daily Metered (NDM). For both categories, the 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. However, as explained below, the rules around amending the capacity booking are different.

Under the current UNC arrangements, if a user wishes to reduce the amount of gas it takes off the system, it is still liable for the capacity element of its charges, corresponding to its historic level of gas off-take. For these customers the capacity charge is based on the maximum peak day flow ('Supply Point Offtake Quantity' or 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 demand with the Gas Distribution Network (GDN). Capacity charges are then immediately recalculated and actual peak 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.

Certain DM customers have argued that these rules are too restrictive and can lead to customers paying charges for capacity that does not reflect their use of the network. To address this issue, Corona Energy raised Modification proposal UNC 244⁶, which the Authority rejected on 20 May 2009⁷. However, in our decision letter, we signalled our expectation that the GDNs carry out an analysis to assess whether there was a better way of addressing this issue. We also 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, unless the GDNs can find other users who wish to use that capacity.

In November 2009, National Grid Distribution raised an urgent Modification Proposal UNC 275⁸ to introduce more flexibility for DM users to reduce their capacity reservation to a level that better reflects their current capacity usage. As a result of the economic

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 The Annual Quantity (AQ) is the annual consumption at a supply point.

⁴ Supply Point Off-take Quantity (SOQ) is the maximum peak day flow.

⁵ Bottom Stop SOQ (BSSOQ) is the highest value of peak day flow (SOQ) measured for the previous year.

⁶ The Modification Proposal papers can be found here: <http://gasgovernance.co.uk/0244>

⁷ The decision letter can be found on our website here:

<http://www.ofgem.gov.uk/Licensing/GasCodes/UNC/Mods/Documents1/UNC244D.pdf>

⁸ The Modification Proposal papers can be found here: <http://gasgovernance.co.uk/0275>

downturn at the time, some customers were experiencing an unprecedented drop in gas demand and as a result, were constrained by a BSSOQ that did not reflect their expected capacity usage. The Authority accepted the modification⁹ as it concluded that its implementation would better facilitate the achievement of the relevant objectives of the UNC, and would be consistent with the Authority principal objectives and statutory duties. However, in our decision letter, we noted that this was a solution for a limited time only (years 2009/10 and 2010/11) and that further work was proposed to develop an enduring modification with permanent changes to the UNC.

The Final Modification Report (FMR) for UNC275 indicates that there was an expectation that the DM capacity regime would be changed as a result of the output from UNC Review Group 264 "Review of Industry Arrangements to Accommodate Reduced Demand at DM Supply Points"¹⁰. We note that subsequently National Grid Distribution raised modification proposal UNC 283 'Removal of Bottom Stop SOQ'¹¹, which was then withdrawn.

The modification proposal

British Gas ('the Proposer') raised modification proposal UNC 405 'Bottom Stop SOQ Appeal Mechanism for 2011/12'¹², as an urgent modification, to extend the "appeal" process established by UNC 275 to the year 2011/2012.

The Proposer is concerned that, as a result of the continued economic downturn, some customers have reduced their activity and are therefore constrained by a BSSOQ that does not reflect their expected usage.

The Proposer is aware of a large customer that is facing transportation costs that do not reflect their current and intended gas requirements, which might consequently lead to the closure of its business. If this was to happen, then the transportation costs not recovered from such a customer would need to be recovered from the remaining customers.

British Gas proposes to allow Users, on behalf of qualifying GDN-connected Daily Metered customers and subject to certain conditions, explained below, to apply for a reduction to their customers sites SOQs below the current BSSOQ levels. Specifically, a User would apply for a concurrent reduction of the BSSOQ and SOQ during the current capacity reduction window.

The conditions mentioned above are:

- An 'appeal' may only be affected during the period 1 October 2011 to 31 January 2012 and must be made via the current UNC rules for making SOQ reductions.
- To be valid, an 'appeal' must seek to set the SOQ and BSSOQ to the same value and such value must be lower than the current BSSOQ value.
- A User may also seek to change the SHQ value via the 'appeal' but the current UNC rules governing the relationship between the SHQ and SOQ will still apply.
- The 'appeal' will be permitted in respect of any site/supply point during the capacity reduction window.

⁹ The decision letter can be found on our website here:

<http://www.ofgem.gov.uk/Licensing/GasCodes/UNC/Mods/Documents1/UNC275D.pdf>

¹⁰ The report can be found here: <http://gasgovernance.co.uk/0264>

¹¹ The modification proposal papers can be found here: <http://gasgovernance.co.uk/0283>

¹² The modification proposal papers can be found here: <http://gasgovernance.co.uk/0405>

- For the avoidance of doubt, following a successful 'appeal' a Registered User may subsequently apply for an increased SOQ at the supply point using existing mechanisms.

The Proposer also notes that Modification UNC275 provides a useful precedent and the arguments advanced in pursuance of that proposal remain valid today.

UNC Panel¹³ recommendation

At the Modification Panel meeting held on 9 December 2009, all 9 voting members present voted in favour of implementing UNC 405.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 9 December 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 FMR¹⁴. The Authority has concluded that:

1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC¹⁵; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties¹⁶.

Reasons for the Authority's decision

We acknowledge the potential problem faced by customers as a result of the current economic climate and recognise that the economic conditions have not improved since UNC 275 was implemented.

As outlined in our previous decision letters, 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 have assessed the proposed modification against the UNC Relevant Objectives and our statutory duties. Since UNC 405 is effectively an extension of UNC 275, the reasons for our decision are consistent across both proposals. It is however disappointing that this extension of the interim solution has been necessitated and that an enduring solution has yet to come out of UNC264.

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

¹³ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules

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: <http://epr.ofgem.gov.uk/index.php?pk=folder590301>

¹⁶The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

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.

Evidence provided by the distribution companies suggest that for at least one big customer SOQ has fallen significantly below the BSSOQ. 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 part of the pipeline unutilised for a period of time. 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 higher than in the past.

In addition, we also note the following:

- The modification is proposed only as a temporary measure and will fall away automatically at the end of January 2012. As already noted, we encourage the GDNs to put in place a more robust and enduring regime to address this issue.
- The proposal includes arrangements to prevent customers from gaming, so that only those that are genuinely experiencing a reduction in gas offtake will make use of the flexibility being offered. The distribution companies have provided information¹⁷ on the number of sites that have used the "appeal" mechanism introduced by UNC 275. Over the 2 year period 14 sites have benefited from the additional flexibility and the total of SOQ reductions has been 5,167,914 kWh. The total reduction in Capacity Charges has been £655,252, approximately 0.01% of total DN income over the 2 years.

Relevant objective (c) – Efficient discharge of the licensee's obligations

In the Proposer's opinion, there will be benefits to all customers in allowing bona fide "appeals" under the proposal if such appeals significantly reduce the likelihood of customers ceasing to take gas. The proposer has not however specified which of the licensees' obligations they are referring to and we believe that the modification proposal is neutral against relevant objective (c).

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

We note that both British Gas and National Grid Distribution consider that implementation of UNC 405 would further relevant objective (d).

British Gas believes that enabling more cost-reflective charging of customers during a period of economic difficulty will facilitate competition between both shippers and suppliers. Also, in the event of large consumers going out of business this will have an adverse impact on competition in shipping and supply.

¹⁷ This was disclosed to Ofgem on a confidential basis.

National Grid Distribution believes that by allowing shippers to book capacity which accurately reflects future use, appropriate charges can be levied thereby securing effective competition between relevant shippers and between relevant suppliers.

We believe that implementing modification proposal UNC 405 would further relevant objective (d), as by recognising a customers' real needs, the market as a whole would operate in a more effective and competitive way.

Finally, we note that if these arrangements result in DM customers paying for 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. As already noted above, the reduction in Capacity Charges in the previous 2 years as a result of UNC 275 has been £655,252 - approximately 0.01% of total GDNs income over 2 years. However, without these new arrangements, there is a higher risk that some DM customers may cease to use the network which would lead to the remainder of customers bearing an even greater redistribution of costs.

Conclusion

We recognise the issue this proposal seeks to address is unique as it is a direct consequence of a severe economic downturn. We also recognise that the 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.

Finally, we encourage the industry to progress the work started by Review Group UNC264 and followed by UNC283. We encourage discussion of this urgent modification proposal at the next UNC Modification Panel as required by paragraph 10.4 of the Modification Rules¹⁸ with a view to either progressing an enduring solution or managing the expectations of consumers who may seek relief from prevailing transportation charges once this appeal window has expired.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority hereby directs that modification proposal UNC 405: ' Bottom Stop SOQ Appeal Mechanism for 2011/12' be made.

Declan Tomany

Associate Partner Legal – Smarter Grids and Governance

Signed on behalf of the Authority and authorised for that purpose

¹⁸ The modification rules of the UNC can be found here:
<http://gasgovernance.co.uk/sites/default/files/TDIV%20-%20Modification%20Rules.pdf>