Modification proposal:	**Uniform Network Code (UNC) 790: Introduction of a Transmission Services Entry Flow Charge (UNC790)**		
Decision:	The Authority[1] has decided to reject this modification[2]		
Target audience:	UNC Panel, Parties to the UNC and other interested parties		
Date of publication:	25/03/2022	Implementation date:	n/a

Background

On 28 May 2020, we approved modification proposal UNC678A: 'Amendments to Gas Transmission Charging Regime (Postage Stamp)'[3] for implementation on 1 October 2020. UNC678A introduced far-reaching changes to the Great Britain (GB) gas transmission charging arrangements and ensured compliance with Commission Regulation (EU) 2017/460 of 16 March 2017 establishing a network code on harmonised transmission tariff structures for gas (TAR NC).[4]

UNC678A, also implemented protections for "Existing Contracts" in response to Article 35(1) TAR NC, which states:

"This Regulation shall not affect the levels of transmission tariffs resulting from contracts or capacity bookings concluded before 6 April 2017 where such contracts or capacity bookings foresee no change in the levels of the capacity- and/or commodity-based transmission tariffs except for indexation, if any".

[1] References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.
[2] This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986
[3] Amendments to Gas Transmission Charging Regime: Decision and Final Impact Assessment (UNC678/A/B/C/D/E/F/G/H/I/J) (28 May 2020) https://www.ofgem.gov.uk/publications/amendments-gas-transmission-charging-regime-decision-and-final-impact-assessment-unc678abcdefghij
[4] Now incorporated in UK law by the European Union (Withdrawal) Act 2018 and the European Union (Withdrawal Agreement) Act 2020, as amended by Schedule 5 of the Gas (Security of Supply and Network Codes) (Amendment) (EU Exit) Regulations SI 2019/531.

Prior to the implementation of UNC678A, a fixed capacity price applied to long-term entry capacity, along with a floating commodity charge which recovered the majority of allowed Transmission Owner (TO) revenues. Following the implementation of UNC678A, transmission services revenue[5] is now recovered solely through capacity-based charges. Capacity bookings are subject to a floating price, with the exception of certain fixed-price capacity bookings registered prior to 6 April 2017 which are classified as Existing Contracts in accordance with Article 35 TAR NC.

In June 2021, we encouraged National Grid Gas (NGG) to develop Uniform Network Code (UNC) changes to further transparency, predictability and stability within the charging regime.[6] In November 2021, NGG raised UNC790: 'Introduction of a Transmission Services Entry Flow Charge'. The modification states that the price protection afforded to Existing Contract Capacity results in a significant price differential between the unit cost of Existing Contract Capacity and "new" Entry Capacity (i.e. capacity booked after 6 April 2017), with Users allocated the latter paying on average 23 times the unit price paid for the equivalent product under an Existing Contract.[7]

The modification proposal

On 8 November 2021, NGG (the Proposer) raised UNC790: 'Introduction of a Transmission Services Entry Flow Charge' and requested that it should be treated as urgent and proceed under a timetable to be approved by Ofgem.[8] On 15 November 2021, we decided to grant urgency to UNC790.[9]

The stated aims of UNC790 are two-fold: firstly, to reduce the overall price differential between Existing Contracts and new capacity; and secondly, to achieve a greater degree of year-on-year stability for Transmission Services Entry capacity tariffs.

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[5] Article 3(6) TAR NC states: "Transmission services revenue" means the part of the allowed or target revenue which is recovered by transmission tariffs.
[6] Response to National Grid Gas statement on the future of gas transmission charging (4 June 2021) https://www.ofgem.gov.uk/publications/response-national-grid-gas-statement-future-gas-transmission-charging
[7] UNC790 Final Modification Report (FMR), page 3.
[8] https://www.gasgovernance.co.uk/0790
[9] UNC790 - Authority Decision on Urgency (15 November 2021) https://www.ofgem.gov.uk/publications/unc790-authority-decision-urgency

The modification proposes to revise how the Entry Capacity Reference Price is calculated. Under UNC790, NGG would calculate the Entry Capacity Reference Price that would apply if Existing Contracts did not exist. This would result in a lower Entry Capacity Reference Price compared to the status quo. If the lower Entry Capacity Reference Price were applied to new capacity then this approach would result in a shortfall from the Entry Transmission Services Allowed Revenue, given the lower rate of revenue recovered from Existing Contract Capacity compared with "new" capacity. This resultant shortfall would be considered attributable to the impact of Existing Contracts on revenue recovery.

An additional flow-based entry charge would then be applied to recover the shortfall between Entry Transmission Allowed Revenue and recovered revenues from Entry Capacity. This new charge would be payable in respect of gas flows at all System Entry Points, except those at Storage Connection Points and Interconnection Points (IPs). A discount to this charge would also be applied in respect of short-haul flows. Upon expiry of Existing Contracts in 2032, this additional charge would be calculated at zero and so would have no effect beyond this date.

UNC Panel[10] recommendation

At the UNC Panel meeting on 16 December, 11 of the 13 present members of the UNC Panel considered that UNC790 would not better facilitate the UNC objectives and the Panel therefore did not recommend its approval. Of the members representing consumers, the Consumer Voting Member voted to recommend implementation, whereas the Non-domestic Consumer Voting Member did not.[11]

Compliance with TAR NC

A number of detailed representations regarding non-compliance have been raised during the UNC consultation, referring specifically to Articles 17 and 18 of TAR NC. Some consultation responses stated that UNC790 is non-compliant with Article 4(3)(b) because it involves artificially creating an *ex ante* expected under-recovery which will never materialise in practice. It was argued that revenue under-recovery is defined in Article 18(1) TAR NC to

[10] The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.
[11] https://www.gasgovernance.co.uk/sites/default/files/ggf/2021-12/Determinations%20Record%2016%20December%202021.pdf

mean "the actually obtained revenue" in respect of transmission services minus "the transmission services revenue" (emphasis added).[12]

We consider that modification proposal UNC790 cannot be reconciled with Articles 17 and 18 TAR NC. Article 4(3)(b) TAR NC is designed to allow reconciliation of the regulatory account. Articles 17 to 20 of TAR NC together form Chapter IV, which is titled "Reconciliation of Revenue". It provides a scheme where the difference between the allowed revenue to be recovered by transmission tariffs in a single tariff period on the one hand, and the actually obtained revenue in the same tariff period on the other, is defined as an under-recovery by Article 18. Article 17 imposes a duty to minimise such under-recovery. Article 19(2) requires that any such under-recovery be attributed to the regulatory account, and Article 20(1) then requires that the reconciliation of that account must be carried out in accordance with the applied reference price methodology and, in addition, by using the charge referred to in Article 4(3)(b), if applied.

Article 4(3)(b)(i) requires that any such charge be levied for the purpose of managing revenue under- and over-recovery. TAR NC recognises that after all best efforts to match the allowed revenue with the transmission charges levied (using the reference price methodology), there may still be a difference which is required to be reconciled. TAR NC does not envisage a possibility where the reference price methodology is deliberately set to under-recover transmission charges, thus shifting charges from capacity-based charges to commodity-based charges *by design*.

Our decision

We have considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 16 December 2021. We have considered and taken into account the responses to the industry consultation on the modification proposal which are attached to the FMR.[13] We have concluded that:

[12] Article 3 (6) TAR NC defines "transmission services revenue" as "the part of the allowed or target revenue which is recovered by transmission tariffs".
[13] UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.co.uk

- implementation of the modification proposal will not better facilitate the achievement of the relevant objectives of the UNC.[14]

Reasons for our decision

We consider this modification proposal will better facilitate UNC Relevant Code Objective (RO) (d) and UNC Charging Methodology Relevant Objectives (CMRO) (aa) and (c), will not better facilitate RO (g) and CMRO (e), and will have a neutral impact on the other relevant objectives. Given the similarities between the applicable UNC objectives, we assess them in tandem.

Objective (d), so far as is consistent with sub-paragraphs (a) to (c), the securing of effective competition between relevant shippers, and CMRO (c) that, so far as is consistent with sub-paragraphs (a) and (b), compliance with the charging methodology facilitates effective competition between gas shippers and between gas suppliers, and CMRO (aa) that, in so far as prices in respect of transportation arrangements are established by auction, reserve price is set at a level best calculated to promote competition between gas shippers

The Proposal would have a positive impact on RO (d) and CMROs (aa) and (c).

The Proposer states that the modification will provide greater stability and predictability for Entry Capacity Reference Prices, which will allow Users to forecast costs with a greater degree of confidence. They argue that this could reduce risk management costs for the industry[15] and bring about more effective competition among Shippers. They also state that their Allowed Revenue at Entry will be recovered in a more equitable manner than it is currently. These arguments received support from some Panel Members. Furthermore, the Proposer argues that as the proposal is expected to provide a more stable and predictable Reference Price for Entry Capacity, it is also expected to reduce the material differentiation in Users' Transportation Charges for the equivalent Transportation service, which is apparent under the current arrangements.

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[14] 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

[15] Assessment of National Grid Gas UNC modification proposal relating to the introduction of an entry revenue recuperation charge, see: https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2021-11/NGG%20charging%20reform%20-%20impact%20assessment%20-%20final%20-%20291121%20stc.pdf

However, some Panel Members felt this modification would have a negative impact on RO (d). They argued that the changes proposed would not guarantee stable and predictable prices and customers may not necessarily see the benefits of the reduction in prices. They further added that the assumption of full cost reflection at the National Balancing Point (NBP) is an oversimplification.

We have previously said[16] that there is a tension between Article 35(1) TAR NC and other legislative requirements in TAR NC and the Gas Regulation[17] regarding efficient competition. Following the implementation of UNC678A, Existing Contracts offer access to entry capacity for a significantly lower average price than capacity which is not protected under Article 35(1) TAR NC and is therefore subject to a floating price. As a result, protection for existing contracts has led to a dual regime in the GB charging methodology where NTS users face significantly different costs for capacity depending on their access to Existing Contracts. This has a negative impact on effective competition.

The FMR states that on average new capacity is 23 times more expensive than Existing Contract Capacity. We agree with the Proposer that the proposed additional charge will likely reduce the disparity in pricing between new and Existing Capacity, allowing for more effective competition between Shippers. Furthermore, under the proposed methodology Allowed Revenue at Entry would be recovered in a more equitable fashion. All else being equal, this would mitigate the impact that variations between actual bookings and Forecasted Contracted Capacity (FCC) have on revenue recovery, therefore leading to increased accuracy in revenue recovery. We would expect this to result in greater pricing stability and increased market confidence as Users could more accurately forecast their future costs. Lastly, under the current arrangements Users face significantly different costs for the same transportation service, an issue that would be somewhat mitigated by the proposal. However, we note that a modification proposal that would levy the additional charge *only* on existing contracts would

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[16] See for instance UNC739: Aggregate overrun regime for Original Capacity held at the Bacton ASEPs (20 August 2021) https://www.ofgem.gov.uk/publications/unc739-aggregate-overrun-regime-original-capacity-held-bacton-aseps
[17] Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks, now incorporated in UK law in accordance with the European Union (Withdrawal) Act 2018 as amended by the European Union (Withdrawal Agreement) Act 2020.

be more effective than UNC790 in closing the price gap between existing contracts and new contracts.[18]

For these reasons, we consider that UNC790 does better facilitate and would have a positive impact on UNC Relevant Code Objective (d) and the CMROs (c) and (aa).

Objective (g) and CMRO (e) compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators

We believe that the Proposal would not better facilitate and would have a negative impact on RO (g) and CMRO (e).

With regards to compliance with TAR NC, the Proposer states that the charge falls within the remit of Article 4(3)(b). When assessing the modification under Article 4(3)(b)(i) the Proposer concluded that the calculation and operation of the charge on an *ex ante* basis is permissible as it is a foundation of the current arrangements that prices are set and applied based on forecasts. Furthermore, the Proposer states that the modification is consistent with Article 17, which imposes a duty to minimise under-recovery and to recover Transmission Services Revenue in a timely manner.

Some Panel Members thought that this proposal would have a negative impact on RO (g) and CMRO (e). These Panel Members noted the number of UNC Consultation responses[19] that highlighted concerns regarding compliance with TAR NC, and subsequently stated that there was sufficient doubt to not be able to recommend implementation on these grounds. As noted in the "Compliance with TAR NC" section, the UNC Consultation responses that raised concerns of non-compliance mostly referred to Articles 17 and 18 of TAR NC. The key objection was that the additional charge proposed by this modification would not fall within the remit of Article 4(3)(b) as it creates an under-recovery on an *ex ante* basis. Article 18 clearly defines under-recovery as the difference between the actually obtained revenue and the transmission services revenue. The modification, meanwhile, would artificially create an under-recovery

[18] At the 5 October 2021 NTS Charging Methodology Forum (NTSCMF) meeting, we noted that the quantities attracting the charge is an important area for the Proposer to consider, see minutes: https://www.gasgovernance.co.uk/ntscmf/051021

[19] 8 out of the 16 responses opposed UNC790 on TAR NC compliance grounds. All the UNC Consultation responses can be found at: https://www.gasgovernance.co.uk/0790

before actually obtained revenue is known and then applies an additional charge to recover this revenue.

We agree with the Panel Members and UNC Consultation responses in regard to the concerns over compliance, for the reasons set out above (in the "Compliance with TAR NC" section). Notably, the complementary revenue recovery charge envisaged under Article 4(3)(b) is for the purpose of reconciling the regulatory account. TAR NC does not envisage a possibility where the reference price methodology is deliberately set to under-recover transmission charges, thus shifting charges from capacity-based charges to commodity-based charges *by design*.

For these reasons, we consider that UNC790 does not better facilitate and would have a negative impact on UNC Relevant Code Objective (g) and the CMRO (e).

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority has decided that modification proposal UNC790: 'Introduction of a Transmission Services Entry Flow Charge' should not be made.

Next steps

We expect industry to bring forward a new modification proposal to address existing contracts as soon as possible, in line with the legal analysis set out in this decision.

We strongly encourage industry to develop a modification which addresses the price differential between new capacity and Existing Contracts, in a compliant manner. The modification should approximate tariffs in respect of Existing Contracts to the pre-TAR NC charging regime as closely as reasonably practicable, while recognising that in reality this cannot be done precisely, and therefore avoid a continued windfall for Existing Contract holders. Such an approach would be entirely consistent with the legitimate expectations generated by the Existing Contracts which Article 35 is designed to protect.

In essence, Article 35 carves out an exception to the operation of TAR NC. It is in our view permissible to introduce charging arrangements to ensure that the tariffs imposed on Existing

Contracts are not “affected” by the new regime and that, as such, they are not materially lower than would otherwise be the case.

Article 35(1) TAR NC means that network users with existing contracts or capacity bookings should not pay higher levels of transmission tariffs than those foreseen in the contracts. However, it also means that it is permissible to introduce arrangements which ensure that they do not pay lower, let alone substantially lower, levels of tariffs than those foreseen in their Existing Contracts. In other words, Article 35 does not necessitate providing those with Existing Contracts with a windfall, simply because the earlier very substantial commodity-based tariffs are not levied on new contracts. Those with Existing Contracts are certainly entitled to the benefit of Article 35 (i.e. in locking in the low capacity-based tariffs), but they should also be required to carry the burden of these contracts, by paying a charge reflecting the previous commodity-based charges they would have expected to pay under them, rather than having this burden lifted by operation of the new system.

David O'Neill
Head of Gas Markets and Systems
Signed on behalf of the Authority and authorised for that purpose