

Modification proposal:	Uniform Network Code (UNC) 0243V: Amendments to the process for initialisation of Enduring NTS Exit (Flat) Capacity at the Moffat NTS Exit Point (UNC243V)		
Decision:	The Authority ¹ has decided to reject this proposal		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	2 April 2009	Implementation Date:	N/A

Background to the modification proposal

The Authority approved UNC0195AV² in January 2009; this brought in the arrangements for enduring exit reform with an implementation date of 1 April 2009. One of the first stages of the implementation process is the allocation of users' initial enduring annual capacity rights for the gas year 2012/13. This will allocate enduring annual capacity rights to Gas Distribution Networks (GDNs) based on their OCS statements for 2011/12 (as agreed in 2008) and will allocate to "direct connects" based on their peak 2007/08 capacity holdings³. UNC195 also provides for the appointment of an exit capacity booking agent to act on behalf of parties at a shared supply meter point or a National Transmission System (NTS) Connected System Exit Point (CSEP). Where all users at such sites agree on the appointment of a given agent and provide National Grid Gas (NGG) NTS with proof of such by 7 April 2009, NGG NTS will provide the booking agent with the aggregate amount of initial enduring annual capacity allocated to that NTS exit point by 16 April 2009. The booking agent is then required to inform NGG NTS of the amount allocated to each individual user at that point by 23 April 2009.

The Moffat exit point serves Northern Ireland (NI), the Republic of Ireland (RoI) and the Isle of Man (IoM). Currently NI and the IoM are totally dependent on this pipeline to source their gas, while up to 95% of the RoI's gas comes through Moffat. It represents about 7% of the gas taken off the NTS. Parties at Moffat are currently subject to a "ticket-to-ride" scheme whereby they can only book capacity at Moffat if they have a certificate from an Irish shipper for an equivalent amount of entry capacity on the Irish/IoM systems. Ever since the enduring exit regime has been proposed, there have been representations from Moffat parties that this exit point should be exempt from the arrangements. Reasons cited include: fears that Moffat shippers might hoard capacity to the detriment of the Irish markets; security of supply might be compromised; and that the Common Arrangements for Gas (the proposed integration of the market across these jurisdictions) are not yet in place and might be hindered by the imposition of the enduring reform rules.

A shipper operating at Moffat has now proposed UNC243V which seeks to defer the impact of UNC195AV at the Moffat exit point.

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 UNC0195AV "Reform of the NTS offtake arrangements (UNC 0116V, 0116BV, 0116CVV, 0116VD, 0116A) and Introduction of Enduring NTS Exit capacity Arrangements (UNC 0195 and 0195AV)", approved on 19 Jan 09

³ Allocations will be scaled back to baseline levels if the initialised value exceeds the baseline

The modification proposal

UNC243V aims to defer the initial allocations of enduring annual capacity to individual users at the Moffat exit point by up to two years. It is claimed that this would give participants the opportunity to set up systems similar to the ticket-to-ride so that NI/RoI/IoM security of supply would not be compromised. It is also claimed that UNC243V would also bring competitive benefits to the Moffat exit point and that, if the proposal is not approved, National Grid Gas (NGG) could receive inefficient investment signals.

UNC Panel⁴ recommendation

At the Modification Panel meeting held on 19 March 2009, of the eight Voting Members present, capable of casting nine votes, eight votes were cast in favour of implementing this Modification Proposal. Therefore the Panel recommended implementation of this Proposal.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 20 March 2009. 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 FMR⁵.

The Authority considers that it does not have sufficient information to decide that implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC.

The Authority has not concluded that implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC⁶, and therefore does not direct that it be implemented.

Overall assessment

In its 0195AV decision, the Authority noted that parties downstream of the Moffat interconnector had expressed concerns about the potential consequences of that modification for the arrangements at Moffat. The Authority assured those parties that any complaints concerning abusive conduct by Moffat shippers would be dealt with quickly and effectively but that the Authority would also consider any further UNC modification proposals submitted in relation to Moffat.

The Authority is required, pursuant to para 15(b) of Standard Special Condition A11 of the transporter's licence to consider whether the proposed modification "in the opinion of the Authority, will, as compared to the existing provisions of the ... uniform network code ..., better facilitate, consistent with the licensee's duties under section 9 of the [Gas Act 1986], the achievement of the relevant objectives." In carrying out its assessment, the

⁴ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

⁵ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com

⁶ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=6547

Authority must also have regard, pursuant to section 4AA of the Gas Act 1986, to (i) its principal objective of protecting "the interests of [existing and future] consumers in relation to gas conveyed through pipes, wherever appropriate, by promoting effective competition between persons engaged in, or in commercial activities connected with the shipping, transportation or supply of gas so conveyed" and (ii) its general duties under that provision including the principles of better regulation set out in section 4AA(5A) that regulatory activities should be "transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed".

For the reasons given below, having assessed the UNC0243V against the relevant objectives, the Authority considers that it has not been provided with sufficient information to support a conclusion that the proposal better facilitates the relevant objectives. In particular, the proposer has failed to establish that the safeguards incorporated in the 0195AV regime would not be sufficient to address any concerns regarding the implementation of that modification at Moffat. The Authority also takes the view that the proposer has failed to provide sufficient information to enable the Authority properly to consider the proposal's full ramifications for other affected parties.

We would also note that the proposal was submitted to Ofgem on 20 March 2009, only 11 days before implementation of 0195AV was due to take effect. Plainly, it could have been submitted at a much earlier stage, either during the development of UNC195, or at the very latest, following publication of the Authority's minded to position on UNC195AV in late 2008⁷.

Consequently, the Authority has had a very limited period in which to assess this proposal and has not been able, in that time, to satisfy itself on the basis of the information submitted that the proposal would not be unduly discriminatory.

Detailed reasons for the Authority's decision

The proposer submits that the relevant objectives set out in sub-paragraphs (a), (c), (d) and (f) of Standard Special Condition *A11.1 (a)* would be better facilitated by the proposed modification. The Authority rejects the arguments put forward by the proposer for the reasons given below.

Standard Special Condition A11.1 (a): the efficient and economic operation of the pipeline system to which this licence relates;

UNC0195AV allocates initial enduring annual capacity (by 1 May 2009) to individual users based on their historic capacity holdings. The proposer of UNC243V believes that breaking the link between traded volumes and capacity booking at Moffat may increase the complexity, risk and costs associated with gas trading at Moffat and make it a less attractive source of gas for the markets in Ireland. The proposer claims that the closer match of booked NTS exit capacity with traded volumes, as envisaged by UNC243V, could be expected to result in better utilisation of booked NTS exit capacity at Moffat, thereby promoting the economic and efficient operation of the system.

However, the proposer of UNC243V has not sought to explain why the safeguard mechanisms built in to UNC195AV to facilitate trading are considered inadequate to ensure an efficient trading outcome. Parties who are assigned enduring annual capacity rights at Moffat under the UNC195AV regime will continue to be dependent on trades with

⁷ "Uniform Network Code - Enduring offtake reform Modification proposals", Ofgem, 2 Dec 08

counterparties in the Irish regime in order to be able to extract value from those capacity rights. If a party has an excess of exit capacity rights, it is in its interest to seek a contractual solution (such as the assignment of the excess capacity to another user) to maximise the value of that capacity right. We consider, in the absence of any evidence presented to the contrary, that this would be just as likely to lead to an efficient outcome as that envisaged by the proposer.

The proposer has indicated that the implementation of UNC195AV could lead to the parties who have been allocated enduring annual capacity at Moffat hoarding their capacity in order to extract more favourable terms from Irish parties. We do not accept the proposer's allegation since there are, in our view, adequate safeguards to prevent this occurring:

- shippers have obligations under Standard Condition 3 of the Gas Shippers licence not to knowingly or recklessly pursue any course of conduct which is likely to prejudice the efficient operation or efficient balancing of the transportation system
- such behaviour would risk contravening competition law and the Authority would consider any complaints that shippers were acting in this manner and, if appropriate, pursue enforcement action
- since overruns are measured against the aggregate flows at the exit point, other shippers who did contract with Irish shippers could flow against this "hoarded" capacity without fear of attracting penalty charges
- the availability of both the "Use It or Lose It" product and the off-peak interruptible product should allay any concerns as to the availability of exit capacity in the event that parties do not use or assign their enduring annual capacity rights
- financial incentives on National Grid to release daily firm incremental capacity where it is available.

The proposer has not provided reasons as to why the above safeguards would be inadequate to protect the interests of downstream shippers at Moffat from hoarding practices. Further, it is disappointing to note that the Final Modification Report that has been submitted to the Authority on this proposal has not considered the impact of the safeguards outlined above.

UNC195AV also provides for multiple user exit points to appoint a booking agent to co-ordinate capacity bookings and allocations⁸. It has been claimed by interests at Moffat that they are unlikely to be able to find an agent to take on the risk, given the volume uncertainty in the fledgling Irish market. However, we have not been provided with any evidence to support this assertion, in particular whether the parties have taken or sought to take steps to appoint an agent, and the Authority is therefore unable to conclude at this time that the appointment of an agent is not a realistic alternative.

Standard Special Condition A11.1 (c): so far as is consistent with subparagraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;

The proposer argues that as a result of the de-linking of booked capacities and traded volumes, users that have been allocated enduring annual capacity but haven't been able to secure equivalent contracts for entry capacity to the Irish network might avail themselves of the option to reduce their holding. This could send NGG NTS inaccurate signals as to the aggregate requirements for Moffat capacity, thereby impacting on NGG

⁸ UNC0195AV "Reform of the NTS offtake arrangements (UNC 0116V, 0116BV, 0116CVV, 0116VD, 0116A) and Introduction of Enduring NTS Exit capacity Arrangements (UNC 0195 and 0195AV)", approved on 19 Jan 09

NTS's ability to comply with their licence obligation to maintain an efficient and economic system. This in turn has the potential to impact on security of supply in the downstream gas and electricity markets in Ireland.

We consider that if a party were to apply to reduce its enduring annual capacity holding, provided that there is no reduction in overall market demand within the NI/RoI/IoM, other parties would seek to obtain the surrendered exit capacity (albeit on a short term/annual basis rather than on an enduring basis) so as to satisfy the overall level of demand. Therefore, NGG NTS would still be receiving signals that relate to the efficient level of *aggregate* demand at Moffat. One of the overriding concerns of Moffat parties about sending inaccurate signals to NGG NTS in relation to aggregate requirements is the potential for the surrendered capacity to be substituted away following the introduction of exit capacity substitution. However, Ofgem has recently deferred the introduction of exit capacity substitution until the July 2011 application window⁹ (which would relate to incremental capacity for 2014 onwards). Given this decision, we do not think this is now a relevant concern in relation to the start of the enduring reform period. It is also worth noting that the methodology for exit substitution has not yet been determined, so for instance, it is still an open issue as to what capacity signals would be incorporated for signalling the long-term requirement of exit capacity at a given exit point.

Contrary to the proposer's submission, we consider that implementing UNC243V could also have a detrimental impact on security of supply for the jurisdictions downstream of Moffat in that UNC243V prohibits the application for incremental capacity at Moffat until the 2011 application window, ie capacity for introduction from 2014 onwards. This would inhibit the early development of incremental exit capacity at Moffat, if it was required.

We have also considered whether the proposed modification is consistent with the licensee's duty under section 9(2)(b) of the Gas Act 1986 to avoid any undue preference or undue discrimination in the terms on which it undertakes the conveyance of gas. Whilst NGG NTS' view is that the proposal is not unduly discriminatory, the Authority has not been given any evidence or cogent reasoning to support this assertion either by the proposer or the licensee. We do not consider that this issue has been adequately explored during the shortened consultation period. It would be inappropriate for us to make a decision on that basis. Therefore, when considered in conjunction with the previous points, we do not believe that it is possible to conclude that UNC243V better facilitates this relevant objective.

We address further concerns as to discrimination in our conclusions on SSC A11.1 (d) below.

Standard Special Condition A11.1 (d): so far as is consistent with subparagraphs (a) to (c) the securing of effective competition:

(i) between relevant shippers;

(ii) between relevant suppliers; and/or

(iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;

The proposer and a number of respondents have argued that implementation of UNC243V would enhance competition and liquidity in the wholesale market at Moffat (relative to the post UNC195AV environment) because wholesale gas trading at Moffat

⁹ "Request to Delay Provision of the Exit Capacity Substitution and Exit Capacity Revision Methodology Statements", Ofgem, 23 February 2009

would become less complex and have lower risk. In particular, the proposer submits that this is because market participants will be able to concentrate on commodity sales, without the need to source NTS exit capacity independently.

However, some respondents submitted to the contrary that retaining a form of downstream certification could potentially limit competition and/or liquidity at the Moffat exit point. One respondent commented that the modification limits the ability of shippers to trade at Moffat in the medium and longer terms unless they are prior certified, which might in turn dissuade some users from entering into new contracts to flow gas via Moffat if they do not believe that they can secure NTS exit capacity. In this connection, a respondent has raised concerns that the modification gives rise to an advantage to shippers active in the downstream market at the time of certification. Another respondent raised concerns that linking capacity to downstream certificates may limit liquidity. One respondent has requested that Ofgem satisfy itself that deciding in favour of this proposal would not result in a commercial advantage for any of the established Moffat users.

The UNC0195AV regime facilitates competition between shippers by establishing a framework that allows for capacity rights to be traded at exit points such as Moffat, accompanied by protections to prevent anti competitive behaviour and hoarding. The Authority takes the view that there is a risk that the implementation of UNC243V would itself lead to a *reduction* in competition at the Moffat exit point by preventing parties from trading at this exit point without a downstream certificate. The current 0195AV arrangements provide for safeguard mechanisms (see discussion above) to ensure that competition downstream is protected.

In the Authority's view, the proposer has not provided any or at least any sufficient evidence to support the assertion that UNC 0195AV would (i) have the effect of restricting or distorting downstream competition at Moffat or (ii) in the event that the 0195AV arrangements did lead to some restriction of competition, that such a restriction could not be remedied through reliance on the safeguard mechanisms provided for by that regime. As such, we do not believe a case has been made by the proposer that there is a need to introduce arrangements that may in fact of themselves have detrimental impacts by inhibiting competition at Moffat.

Standard Special Condition A11.1 (f): so far as is consistent with subparagraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code;

The proposer considers that the delayed allocation of enduring annual capacity rights to individual users would facilitate this objective, since allocations made in the future are more likely to match with actual user needs in 2012 and therefore would reduce the administrative burden of reallocating capacities amongst users. However, the proposer has not addressed the additional burden on NGG NTS which may result from having to maintain two parallel systems for capacity allocation. A number of respondents noted the short timescales under which this proposal was introduced and the consequential risk of unforeseen consequences arising should it be approved.

Therefore, the Authority is unable to conclude on the basis of the information provided that the proposal better facilitates this relevant objective.

Stuart Cook
Director, Transmission

Signed on behalf of the Authority and authorised for that purpose.