

Modification proposal:	Uniform Network Code (UNC) 0284: Removal of the Zero Auction Reserve Price for Within-day Daily NTS Entry Capacity (WDDSEC) (UNC284)		
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:	6 August 2010	Implementation Date:	N/A

Background to the modification proposal

Gas users wanting to bring gas onto the National Transmission System (NTS) have to purchase the appropriate volume of NTS entry capacity from National Grid Gas (NGG). Entry capacity is sold through a series of auctions spanning a range of time periods, from quarterly blocks up to 17 years ahead, right down to within-day sales.

NGG recovers the entry portion of its Transmission Owner (TO) allowed revenue through TO entry capacity and commodity charges. NGG receives TO revenue for entry capacity through the entry capacity auctions (except from within day sales of NTS entry capacity, which is counted as System Operator (SO) revenue); the commodity element of revenue is derived from a volume-based charge which seeks to ensure that NGG achieves its TO allowed revenue, should there be a shortfall in the capacity revenue (relative to the TO allowed revenue).

The auctions have a reserve price which bids must equal or exceed in order to be allocated capacity. This reserve price is calculated by application of the gas transmission transportation charging methodology, and is based on the Long Run Marginal Cost (LRMC) at each entry point. The reserve price for a day's worth of entry capacity is equal to 1/365th of the annuitised and adjusted² LRMC.

NGG offers discounts at auctions for daily firm entry capacity products, as follows:

- Day ahead auction: 33.3% discount on the reserve price
- Within day auction: 100% discount on the reserve price i.e. a zero reserve price

At the auctions for daily interruptible entry capacity the reserve price is also set at zero. Users pay the price at which capacity is allocated for all auctions of NTS entry capacity; the price is not adjusted for inflation if bought in previous years.

In recent years, the commodity element of the TO revenue recovered by NGG has been growing, such that it currently constitutes the majority portion of the recovered revenue. Some users have expressed concern about the level and volatility of the commodity charge. NGG instigated a review of the entry charging arrangements to see if an alternative charging scheme which would address these concerns could be devised³.

The review group identified three key sources for low auction revenues, namely:

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 These include adjustments so that a 50:50 split between entry and exit charges is maintained and that a minimum reserve price of 0.0001 p/kWh/day is applied to avoid negative reserve prices.

³ See 'Discussion report: Modification Proposal to the Gas Transmission Transportation Charging Methodology & Associated UNC and Licence Issues, NTS GCD 08R: NTS Entry Charging Review' dated 15 March 2010 & 'Review Group Terms of Reference' both published on NGG's website, www.nationalgrid.com

- Price paid: resulting from the reserve price discounts for daily capacity.
- Model changes: the Transportation model replaced the previous network model (Transcost) in 2007⁴. Prices based on Transcost were generally lower than those set via the Transportation model. As capacity can be bought up to 17 years in advance at auctions the lower prices set via Transcost will be important for a number of years.
- Peak amount of entry capacity procured: NGG noted that if entry capacity was procured at prevailing reserve prices at the forecast level of supply published in the Ten Year Statement (TYS)⁵ then NGG would over-recover its TO allowed revenue. However, users do not book entry capacity up to this level ahead of the gas day, i.e. before the reserve price is set at zero.

The review group developed a number of change proposals and submitted these to Ofgem for decision, these were GCM19, UNC284 and UNC285. This decision letter concerns modification proposal UNC284 only.

The modification proposal

UNC284 was raised by National Grid NTS and proposes that the reserve price for within day auctions of entry capacity is that stated in the charging methodology statement. Specifically it removes wording from the UNC stating that the reserve price for within day auctions of entry capacity is zero.

UNC 284 is intended to facilitate implementation of the proposal to modify the gas transmission transportation charging methodology, GCM19⁶. This proposed removing the discounts on the reserve price for the daily entry capacity auctions (both day-ahead and within day) such that the reserve price for daily entry capacity auctions would be equal to the reserve price in the entry capacity monthly auctions.

The proposer considers that UNC284 will better facilitate the following UNC relevant objectives⁷ :

- Efficient and economic operation of the pipe-line system to which the licence relates
- Efficient discharge of the licensee's obligations under the licence
- The securing of effective competition between relevant users

In order to facilitate the implementation of GCM19, as well as modification proposal UNC284, the review group also developed a further UNC modification proposal, UNC285. This proposes restricting the release of Use-It-Or-Lose-It (UIOLI) interruptible entry capacity⁸ to situations where ten per cent or less of firm entry capacity remains unsold after the entry capacity rolling monthly auctions.

⁴ See Ofgem decision on GCM01 'Alternative methodologies for determination of NTS entry and exit capacity prices', which was published on Ofgem's website www.ofgem.gov.uk on 24 April 2007 with reference number 94/07. GCM01 implemented the Transportation model with effect from 1 October 2007.

⁵ The Ten Year Statement (TYS) is published by NGG annually. It sets out the forecast of NTS usage and likely developments on the NTS.

⁶ See NGG's 'Conclusions report to the Authority: Modification Proposal to the Gas Transmission transportation Charging Methodology – NTS GCM 19R: Removal of NTS Daily Entry Capacity Reserve Price Discounts' published on NGG's website www.nationalgrid.com on 30 April 2010.

⁷ As set out in Standard Special Condition A11(1)(a) to (f) of the NGG's gas transporter licence for the NTS.

⁸ Under UNC provisions NGG is required to offer unused NTS entry capacity (the 'UIOLI amount') as interruptible NTS entry capacity. The UIOLI amount is the average unused NTS entry capacity i.e. firm NTS entry capacity sold minus the proportion of that NTS entry capacity used to flow gas over a recent 30 day period.

No changes to xoserve's systems or processes were identified as a result of UNC284 and so it is not presented as a User Pays proposal.

UNC Panel⁹ recommendation

At the modification panel meeting held on 20 May 2010, of the nine voting members present, capable of casting ten votes, seven votes were cast in favour of implementing UNC284. Therefore the panel recommended implementing UNC284.

Impact assessment

On 24 June 2010 Ofgem published its impact assessment¹⁰ on the suite of proposals. We received twelve responses¹¹, of which two were confidential. Six respondents, in general, supported implementation of the proposals (including UNC284) and six did not support their implementation.

A detailed summary of the responses to the impact assessment is included as an appendix to the decision on GCM19¹².

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 24 May 2010. 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 FMR¹³ and responses to the impact assessment carried out by Ofgem.

The Authority has concluded that implementation of the modification proposal will not better facilitate the achievement of the relevant objectives of the UNC¹⁴.

Reasons for the Authority's decision

Special Condition A11(c): so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under the licence;

As noted above, UNC284 is an enabling modification proposal which is required to facilitate implementation of GCM19. UNC284 proposes that the reserve price for within-day auctions is quoted in the charging methodology statement and removes specific wording from the UNC that the reserve price for the within-day auction is zero. UNC284 assumes that GCM19 is implemented, which would, amongst other things, remove the 100 per cent discount on the reserve price for within-day auctions (from its current level of zero) from the charging methodology statement. Without implementation of GCM19,

⁹ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

¹⁰ See 'Review of NTS entry charge setting arrangements – Impact assessment', which was published on Ofgem's website www.ofgem.gov.uk on 24 June 2010, with reference number 77/10.

¹¹ The non-confidential responses can be found under 'Review of NTS entry charge setting arrangements – Impact assessment', which was published on Ofgem's website www.ofgem.gov.uk on 24 June 2010, with reference number 77/10.

¹² See the Authority decision 'Modification Proposal NTS GCM 19 "Removal of NTS Daily Entry Capacity Reserve Price Discounts"' published on Ofgem's website www.ofgem.gov.uk on 2 August 2010.

¹³ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com

¹⁴ 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

the charging methodology statement will continue to state that the reserve price for within-day auctions is zero and, therefore, on its own, UNC284 has no impact on the level of reserve prices.

As the Authority concluded that GCM19 does not better facilitate the charging methodology objectives and vetoed its implementation¹⁵ we consider that UNC284 no longer has independent meaning and would not better facilitate the efficient discharge of NGG's obligations under the licence. A fuller discussion of our reasons for vetoing GCM19 and hence why we are rejecting UNC284, including our responses to the main issues raised through industry responses to the impact assessment, is provided in the Authority's decision letter on GCM19 published on 2 August 2010.

Stuart Cook
Senior Partner, Transmission & Governance
Signed on behalf of the Authority and authorised for that purpose.

¹⁵ See the Authority decision 'Modification Proposal NTS GCM 19 'Removal of NTS Daily Entry Capacity Reserve Price Discounts'' published on Ofgem's website www.ofgem.gov.uk on 2 August 2010.