

Modification proposal:	Uniform Network Code (UNC) 426: Amendment to the NTS System Entry Overrun Charge		
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:	20 December 2012	Implementation Date:	N/A

Background to the modification proposal

One of the fundamental principles of the current gas transmission capacity regime is the 'ticket to ride' principle². This principle is that shippers should acquire or purchase capacity rights to cover their flows of gas onto National Grid Gas Transmission's (NGGT) National Transmission System (NTS) and that there should be no incentive for a shipper to flow gas in excess of its entry capacity rights (overrunning). Overrun charges are designed to (i) provide strong commercial incentives to purchase capacity before flowing gas and (ii) ensure the costs of a participant overrunning are targeted back to that shipper.

Under the current regime there can be two situations on a gas day that result in no overrun charge even though there is an overrun quantity:

- when all entry capacity is purchased at zero cost (e.g. where there is a 100% discount to the usual reserve prices)³.
- when all the capacity available at the entry point remains unsold.

The proposer (National Grid NTS, NGGT) considers that if overrunning occurs at no charge then the incentive on users to book capacity consistent with their entry flow requirement is weakened.

A similar argument was used in UNC119 Amendment to the NTS System Entry Overrun Charge⁴ which also was raised because of other potential auction signal distortions. We rejected UNC119, in part because the proposed default overrun price was not cost reflective.

The modification proposal

The proposal is to create a default charge to users on any overrun quantity that would otherwise attract no charge. UNC Transportation Principle Document (Section B 2.12.3) would be amended so that a default overrun price of eight times the Annual Monthly System Entry Capacity (AMSEC) auction reserve price at that entry point is applied to any overrun quantity that formerly attracted no charge.

This is a user pays modification and the cost of implementing the proposal on Gemini is estimated to be between £86,000 and £102,000. These costs would be shared on an equal basis between NGGT and shippers. Costs would be allocated to shippers according

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 <http://www.ofgem.gov.uk/Licensing/GasCodes/UNC/Mods/Archive/5986-653.pdf>. Ofgem decision on Transco Mod 0653 'Revision of entry capacity overrun charges', 13 February 2004

³ Assuming no offer price, forward price, or exercise price applies.

⁴ <http://www.gasgovernance.co.uk/0119>. Amendment to the Entry Overrun Charge. Ofgem decision letter 27 March 2007

to the end of day capacity holdings on the date of implementation. The proposal would not be implemented until NGGT provides Workgroup with information on an increase in the materiality of the issue, or evidence emerges of shippers deliberately overrunning at no cost. In the meantime, the opportunity to implement the proposal at a lower cost would be monitored. If there was an opportunity to implement the proposal at a lower cost the Uniform Network Code Committee would assess whether this would be desirable.

UNC Panel⁵ recommendation

At its meeting on 15 November 2012, the Modification Panel voted unanimously in favour of implementing the modification proposal.

The Authority's decision

We have considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 15 November 2010. We have considered and taken into account the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR⁶.

We have concluded that:

- 1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC⁷; but that**
- 2. directing that the modification be made would not be consistent with the Authority's principal objective and statutory duties⁸.**

Reasons for our decision

The proposer and Workgroup suggest that the modification has a positive impact on relevant objectives a), c) and d), and that it has no impact with respect to the other objectives. We consider that the proposal could have a small but positive effect on the efficient operation of the pipe-line system. We are neutral as to its effects on the long term development of the network and on its effects on competitiveness.

SSC A11 (a)- the efficient and economic operation of the pipe-line system to which this licence relates

The proposer and the other two respondents to the consultation consider that this mechanism will strengthen the 'ticket to ride' principle as described above. However, we consider that this principle was developed in the context of long term capacity allocation and there is no evidence that this was taken into account.

The need that is being considered is one which may arise in short term allocation when no capacity has been sold for that particular day or capacity has been released through anti-hoarding measures at zero cost. The evidence that has been presented on past behaviour (the table in section 2 of the FMR) suggests that on some occasions shippers are not booking capacity even though it is available for free. In our view this represents a

⁵ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

⁶ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com

⁷ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: <http://epr.ofgem.gov.uk/Pages/EPRInformation.aspx?doc=http%3a%2f%2fepr.ofgem.gov.uk%2fEPRFiles%2fStandard+Special+Condition+PART+A+-+Consolidated+-+Current+Version.pdf>

⁸ The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

failure of the shipper's booking process and the responsible shippers should consider whether in other circumstances there may be financial consequences if there is poor attention to detail in this process.

We also consider that it is NGGT's responsibility to have in place efficient mechanisms for managing the allocation of capacity and flows. The current mechanisms allow NGGT to affect shipper behaviour. For example, NGGT has the ability under UNC TPD Part C Section 4 to reject renominations in which the implied renomination exceeds 1/24 of the user's available NTS entry capacity. The FMR is silent on whether some of the larger overruns reported could have been curtailed in this way.

We accept that a minimum overrun price may assist in efficient operation of the pipe-line system but consider that the information and efficiency benefits are likely to be very small. This would be particularly the case relative to other possibilities for changes in short term network management. For example, in the current regime it is possible to obtain capacity after flow. This would be a legitimate strategy on the day but would not fall within the 'ticket to ride' principle and also provides information difficulties in system operation.

SSC A11(1)(c)- so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence.

Both the proposer and one other respondent to the consultation consider that the modification achieves this objective. The proposer indicates that incentivising appropriate capacity booking would be consistent with facilitating NGGT's licence obligations with respect to economic and efficient system development. However, sufficient information has not been provided to demonstrate that long term capacity booking decisions are being appreciably influenced by the potential to overrun without penalty within a future gas day.

SSC A11 (1) (d)- so far as is consistent with relevant objectives (a) to (c) the securing of effective competition between relevant shippers.

Both the proposer and one other respondent to the consultation considered that the modification achieved this objective. The proposer suggests that the modification will deliver an appropriate allocation of costs between users as it will ensure that shippers pay for use of the system when no capacity has been booked. As short term capacity is likely to be available at zero cost, this argument is most relevant to long term signals. As for SSC A11 (1) (c), long term signals are not demonstrably being influenced by the possibility of overrunning without penalty on a particular day.

With respect to cost reflectivity a comparison with the overrun charge on exit capacity suggests that the overrun charges are not directly comparable. On exit the overrunning user becomes liable for buy-back costs at adjacent entry points, so even in this case the consequences of overrunning might be seen to have a strong cost reflective element. Thus, while we accept the case that overruns will not necessarily be cost reflective, we do not accept the argument that cost reflectivity should be a subsidiary consideration.

We note that in the proposal the default overrun charge would be based on eight times the reserve price at that entry point rather than the eight times the highest reserve price on the system (as in UNC 119). In our view this reduces the potential misalignment between the overrun charge and network costs. However, there remains an issue in that there has been no evidence presented to us that virtual overruns on the network have any impact on network costs.

Wider statutory duties

Our principal objective in carrying out our functions is to protect the interests of consumers. Our primary reason for rejection is that we believe that ultimately a significant proportion of implementation costs will fall on consumers while commensurate benefits have not been demonstrated. The four year period analysed in the FMR only shows benefits of £37,000 which is small relative to the potential implementation costs of up to £102,000.

Other considerations

NGGT acknowledges that the cost effectiveness is poor but suggests it may change in the future. Our view is that there is an inherent weakness in the proposal in that the need for the proposal is expressed with reference to the possibility of future overruns at Moffat which would have no cost.

The workgroup recommended that NGGT keep the number of overruns and their source under review. However, the implementation process contains a number of ambiguities. The trigger for system development is not well defined and it is not entirely clear who takes the decision to implement the modification. This is material because in the event of a few large overruns at an entry point with virtual flows (which do not impose network costs) there could be subsequent expenditure of £102,000. Alternatively, slightly lower costs might be identified against a background of reducing overruns which might lead to implementation even though cost effectiveness is unchanged.

One respondent suggested that the modification should be implemented immediately. We do not agree with this view as at present the change does not appear to be cost effective. Another respondent pointed out that if the cost of implementing was shared according to end of day capacity holdings, then the party triggering the change might not have to bear any cost. We consider that this allocation of costs may not be optimal but we recognise the need for a simple means of implementation.

Conclusion

The cost effectiveness of this modification has been acknowledged as poor by the proposer and Workgroup. We are concerned that the implementation costs will ultimately be borne by consumers. In our view, the benefits in terms of relevant objectives, relate to *SSC A11 (a)* but are likely to be limited and may not outweigh the cost of implementation.

We would welcome resubmission of the case when NGGT has better evidence that a cost effective change could be made. This would require evidence that the problem is of a sustained and substantive nature. Ideally, such a submission would clearly distinguish between virtual overruns and actual physical overruns and provide detail on how the worst occurrences were managed.

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