

Modification proposal:	Uniform Network Code (UNC) 727: Increasing the Storage Transmission Capacity Charge Discount to 80%		
Decision:	The Authority ¹ directs this modification be made ²		
Target audience:	UNC Panel, Parties to the UNC and other interested parties		
Date of publication:	18 December 2020	Implementation date:	1 October 2021

Background

On 28 May 2020, we approved modification proposal UNC678A: 'Amendments to Gas Transmission Charging Regime (Postage Stamp)' and decided that it should be implemented on 1 October 2020. The implementation of UNC678A is a significant reform of GB's gas transmission charging regime. UNC678A contains a 50% discount for capacity-based transmission tariffs at entry points from and exit points to storage facilities. A 50% discount is the minimum for storage sites mandated by Commission Regulation (EU) 2017/460 of 16 March 2017 establishing a network code on harmonised transmission tariff structures for gas ("**TAR NC**").

Three UNC678 modification proposals (UNC678C/E/F) proposed an 80% storage discount but these proposals also contained other components that were not compliant with the relevant legislation. In our final decision on UNC678, we said that: ". CEPA's analysis suggested that the change to tariff arrangements could introduce the potential for erosion of storage revenues which could affect closure decisions".³ Based on CEPA's modelling, the estimated reduction in revenues of gas storage facilities was 62% from the implementation of modification UNC678A.⁴

The modification proposal

Storengy UK Ltd ("**the Proposer**") has raised UNC727: 'Increasing the Storage Transmission Capacity Charge Discount to 80%'⁵, proposing to increase the discount for capacity-based transmission tariffs at storage facilities from 50% to 80%. A request for urgent status was made on 5 June 2020 which was granted by Ofgem on 12 June 2020.⁶ We received the Final Modification Report ("**FMR**") on 3 July 2020.

The Proposer states that "the discount should be increased to 80% to prevent significant commercial impact for Storage Users which would ultimately have an adverse impact on security of price and supply for the GB market"⁷.

The Proposer cites quantitative analyses, including modelling carried out by CEPA as part of the UNC678 Impact Assessment⁸. The Proposer states that the current 50% discount

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 See UNC678/A/B/C/D/E/F/G/H/I/J Final Decision (28 May 2020) <https://www.ofgem.gov.uk/publications-and-updates/amendments-gas-transmission-charging-regime-decision-and-final-impact-assessment-unc678abcdefghij>

⁴ See UNC678/A/B/C/D/E/F/G/H/I/J Final Impact Assessment (28 May 2020), §1.89.

⁵ <https://www.gasgovernance.co.uk/0727>

⁶ UNC727 Increasing the Storage Transmission Capacity Charge Discount to 80%: Urgency Application <https://www.ofgem.gov.uk/publications-and-updates/unc727-increasing-storage-transmission-capacity-charge-discount-80-urgency-application>

⁷ See UNC727 Final Modification Report ("**FMR**"), page 3.

⁸ See UNC678/A/B/C/D/E/F/G/H/I/J: Amendments to Gas

“will have a significant detrimental effect on the revenues of GB gas Storage Facilities and thereby their viability.”

The FMR sets out qualitative benefits provided by storage facilities to the GB gas market. It states that storage facilities deliver price stability benefits to consumers and National Grid Gas Transmission (“**NGGT**”) by dampening spikes in the price of gas and reducing market price volatility. The FMR argues that storage facilities deliver significant cost savings to the National Transmission System (“**NTS**”) and ultimately customers. The Proposer says that storage “delivers transmission benefits in terms of avoided investment in additional capacity.” The Proposer also states that gas storage facilities support security of supply by providing “cost effective and reliable insurance against supply disruptions, demand spikes and excess supply.” The FMR cites additional papers containing arguments for a higher storage discount.

UNC Panel⁹ recommendation

At the UNC Panel meeting on 3 July 2020, the UNC Panel voted unanimously to recommend implementation of UNC727.

An 80% storage discount was included in three of the UNC678 alternatives. As a result, stakeholders have been consulted on the 50% storage discount proposed by UNC678A and the 80% discounts proposed by UNC678C/E/F in our UNC678 minded to decision consultation which ran for two months from 23 December 2019.

UNC727 was subject to an industry-led consultation from 11 June 2020 to 26 June 2020. Fourteen representations were received from interested parties. These are available on the Joint Office of Gas Transporters’ website and summaries are provided in the FMR¹⁰. Of the 14 representations, 10 supported implementation, 1 offered qualified support, 1 provided comments and 2 were not in support.

Our decision

We have considered the issues raised by the modification proposal and the FMR. We have considered and taken into account the responses to the industry consultation on UNC727 and the relevant responses submitted to us as part of our minded to decision consultation on UNC678. We have concluded that:

- implementation of the modification proposal will better facilitate the achievement of the UNC Relevant Code Objectives and the UNC Charging Methodology Relevant Objectives;¹¹ and
- directing that the modification be made is consistent with our principal objective and statutory duties.¹²

Transmission Charging Regime: final impact assessment (28 May 2020),

https://www.ofgem.gov.uk/system/files/docs/2020/05/unc678_-_impact_assessment_1.pdf

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

¹⁰ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.co.uk.

¹¹ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, available at: <https://epr.ofgem.gov.uk/Content/Documents/Standard%20Special%20Condition%20-%20PART%20A%20Consolidated%20-%20Current%20Version.pdf>

¹² 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 as amended.

Reasons for our decision

The FMR includes an assessment of the UNC Relevant Code Objectives and the UNC Charging Methodology Relevant Objectives (“CMRO”). Given the similarities between the UNC Relevant Code Objectives and the **CMROs**, we assess them in tandem.

We consider this modification proposal will better facilitate UNC relevant methodology objectives (a) and (b) and has a neutral impact on UNC relevant methodology objectives (d), (e) and (g) and UNC CMRO (a), (aa), (c) and (e).

We also consider this modification will better facilitate our principal objective of protecting the interests of consumers as required by section 4AA of the Gas Act 1986.

UNC Code Relevant Objective (a) the efficient and economic operation of the pipe-line system to which this licence relates

UNC Code Relevant Objective (b) so far as is consistent with sub-paragraph (a), the coordinated, efficient and economic operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters

We consider that UNC727 will have a positive impact on UNC code relevant objectives (a) and (b). GB storage facilities comprise of medium ranged storage assets.¹³ Storage can improve the efficiency of system operation and reduce operating costs by providing additional pressure to the system¹⁴. The Proposer argues that storage provides a benefit to the transmission system in terms of avoided investment in additional capacity.¹⁵ We agree that there is merit in these arguments. We consider that the proposed higher storage discount would facilitate the continued contribution of storage to the efficient and economic operation of the pipe-line system.

UNC Code Relevant Objective (d) so far as is consistent with sub-paragraphs (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

UNC CMRO (aa) that, in so far as prices in respect of transportation arrangements are established by auction, either: (i) no reserve price is applied, or (ii) that reserve price is set at a level - (I) best calculated to promote efficiency and avoid undue preference in the supply of transportation services; and (II) best calculated to promote competition between gas suppliers and between gas shippers

UNC 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

¹³ Medium range storage refers to gas storage which principally cycle gas multiple times a year, in contrast to long range storage which primarily store gas on a seasonal or strategic basis.

¹⁴ See CEER Final Vision on Regulatory Arrangements for the Gas Storage Market. <https://www.ceer.eu/documents/104400/-/-/36342e13-ac21-b801-6219-c4bdb7fc000c>

¹⁵ <https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/book/2019-04/GCR%20Gas%20Storage%20Benefits%20Document%20%28provided%20by%20Alex%20Nield%2003April19%29.pdf>

Overall, UNC727 will have a neutral impact on UNC Code Relevant Objective (d) and UNC CMRO (aa) and (c).

While the majority of respondents to the industry consultation considered that the impact of UNC727 on competition would be positive, two respondents considered that UNC727 would have a negative impact on competition. One respondent said that: "An 80% capacity storage discount for storage Users would have a negative impact on competition between Users of other flexibility assets like bi-directional interconnectors". This respondent argued that granting a higher discount for storage "is only appropriate if discounts are equally considered and applied to other assets providing the same benefits", noting that "[a] number of other assets including interconnectors provide wider benefits to GB also".

TAR NC requires a discount for storage facilities (Article 9(1) TAR NC). There is no equivalent provision requiring (or allowing) a discount for interconnectors. As UNC727 provides a higher discount at storage facilities, all else equal, it will, albeit marginally, increase prices at non-storage NTS points including interconnectors. TAR NC states that the purpose of the discount for storage facilities is, among other things, "to avoid double charging for transmission to and from storage facilities."¹⁶ The risk of double charging within the GB charging methodology arises from the fact that shippers must pay for gas to exit the NTS in order to be injected into a storage facility and then pay for gas to re-enter the NTS. In addition, the same molecule of gas will have paid a full entry charge when first entering the NTS and a full exit charge when it will exit the NTS to final demand. This is unique to storage amongst flexibility assets. We consider therefore that the discount at storage facilities required by TAR NC would not have a negative impact on competition as it recognises the unique position of storage facilities within the GB gas charging methodology.

Irrespective of the principle-based argument above, based on CEPA's modelling, we expect the impact of the 80% discount on competition among flexibility providers will be marginal.¹⁷ While transmission charges for storage will decrease directly, the impacts on charges paid by users (including users of other flexibility assets) will be marginal¹⁸. As we said in our UNC678 final Impact Assessment: "Given the small proportion of cost recovery which is contributed by storage facility entry and exit bookings, CEPA find that the additional revenue recovery requirements resulting from an 80% discount only lead to a marginal change in the tariffs at other entry and exit points on the system."¹⁹ We note that while in principle any change in tariffs can affect the merit order, this was not observed in CEPA's modelling.

UNC Code Relevant Objective (e) so far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards are satisfied as respects the availability of gas to their domestic customers

UNC727 will have a neutral impact on UNC Code Relevant Objective (e). In our UNC678 final decision we said that: "We remain of the view that any security of supply impacts [of an 80% storage discount] are likely to be related to price stability rather than physical security." We continue to consider UNC727 to have a neutral impact on this objective.

¹⁶ Recital 4 of Preamble to TAR NC.

¹⁷ See CEPA Final Analytical Support (May 2020), Section 3.5.

¹⁸ See CEPA Final Analytical Support (May 2020), Section 3.2.

¹⁹ See UNC678/A/B/C/D/E/F/G/H/I/J final impact assessment (28 May 2020), §1.39. See also CEPA's Analytical Report, Table B.23.

UNC Code Relevant Objective (g) 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

UNC 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 consider that UNC727 will have a neutral impact on UNC Code Relevant Objective (g) and UNC CMRO (e). Article 9(1) TAR NC states that: "A discount of at least 50% shall be applied to capacity-based transmission tariffs at entry points from and exit points to storage facilities..." This discount is provided in order to avoid double charging for transmission to and from storage facilities and in recognition of storage's general contribution to system flexibility and security of supply²⁰. Unlike the optional discounts provided for in Article 9(2), the discount for storage facilities is mandatory. Furthermore, the provision states that the discount of 50% is the minimum discount required, therefore a discount higher than 50% is compliant with Article 9(1) TAR NC. We also observe that a storage discount above 50% has been approved in the majority of Member States that have implemented TAR NC.²¹

UNC CMRO (a) save in so far as paragraphs (aa) or (d) apply, that compliance with the charging methodology results in charges which reflect the costs incurred by the licensee in its transportation business

We consider that UNC727 has a neutral impact on UNC CMRO (a). In our UNC678A decision, we said that a key principle of gas charging in the GB network is the fair recovery of costs. When examining this relevant objective in our UNC678A decision, we said that "we do not consider discounts to the RPM to be appropriate except where they can be properly justified based on the costs which network users introduce or save in relation to the NTS or where they can be justified based on other relevant objectives". We also recognised that arguments in favour of storage discounts above 50% are not without merit. We consider that the higher discount proposed under UNC727 is duly justified in light of the contribution of storage to the gas system (efficiency of system operations and price stability) and is broadly in proportion to the additional costs that the use of storage imposes on the system. We consider that an exemption of storage from gas charges (i.e. 100% discount) would not be consistent with the principle of fair recovery of costs and therefore would have a negative impact on this objective.

Ofgem's principal objective and statutory duties

CEPA's UNC678 analysis found that introducing an 80% storage discount to the Postage Stamp Methodology would be beneficial for GB consumers. CEPA found that it would lead to a small improvement of Net Present Value for gas consumers over a ten-year period.²² The inclusion of the proposed 80% storage discount would help to further our principal objective of protecting the interests of gas consumers by preserving the ability of gas storage facilities to provide price stability benefits. In our UNC678 final decision we said

²⁰ Recital 4 of Preamble to TAR NC.

²¹ See the internal gas market in Europe: The role of transmission tariffs. EU Agency Report on the application of reference price methodologies in Member States (6 April 2020), Annex III https://acer.europa.eu/Official_documents/Acts_of_the_Agency/Publication/The%20internal%20gas%20market%20in%20Europe_The%20role%20of%20transmission%20tariffs.pdf

²² See CEPA UNC678 Analytical Report (28 May 2020), page 120 (TD, NPV, 2022-31, £m 2018/19) https://www.ofgem.gov.uk/system/files/docs/2020/05/cepa_unc678_analytical_report.pdf

that: “[I]n theory, gas storage facilities may bring price stability benefits in times of system stress such as helping to dampen price spikes while reducing price volatility more generally”. CEPA’s analysis of the impacts on gas storage facilities found that a 50% discount could significantly impact storage revenues²³. CEPA estimated that UNC678A would reduce gas storage facility revenues by 62% compared to the relevant baseline. When modelling an 80% storage discount, the reduction in revenues was 10% compared to the same baseline. Based on this analysis, we consider that an 80% storage discount would facilitate the continued contribution of storage facilities to the GB gas system and therefore would benefit GB consumers.

Implementation date

UNC727 proposes that implementation take effect in line with any Ofgem direction.

When we granted urgent status to UNC727, we asked the Joint Office of Gas Transporters to include a question in the industry consultation on compliance of the modification, including compliance of the proposed implementation date with Articles 28-32 of the TAR NC. We said we expected parties to give this question due consideration. We have considered the respondents’ views on this question.

Articles 29 and 32 TAR NC together require advance publication of the reserve prices applicable to standard capacity products until at least the end of the gas year, at least 30 days before the annual yearly capacity auction. These publication requirements apply in respect of prices applicable at interconnector points. As UNC727 provides a higher discount at storage facilities, all else equal, it will, albeit marginally, increase prices at non-storage NTS points including interconnectors.

TAR NC allows for a revenue recovery charge to be used in order to achieve reconciliation of revenue. However, this is for the purposes of allowing the reconciliation of under- or over-recovery of the transmission services revenue, where the actual obtained revenue related to the provision of transmission services differs from the allowed revenue. Using the revenue reconciliation process to introduce the 80% storage discount for the gas year 2020/21, as proposed, would be contrary to Articles 29 and 32 TAR NC.

For these reasons, the implementation date will need to allow the 30-day advance publication of the new tariffs reflecting the higher storage discounts. As the next annual yearly capacity auctions are in July 2021 for capacity from October 2021, we have decided that the implementation date for UNC727 shall be **1 October 2021**.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters licence, the Authority hereby directs that modification proposal UNC727: ‘Increasing the Storage Transmission Capacity Charge Discount to 80%’ be made, in accordance with the implementation date directed above.

David O’Neill

Head of Gas Markets and Systems, Energy System Management and Security

Signed on behalf of the Authority and authorised for that purpose

²³ See CEPA UNC678 Analytical Report (28 May 2020), Section 4.1.2.