

Consultation

UNC728/A/B/C/D ('Introduction of a Conditional Discount for Avoiding Inefficient Bypass of the NTS'): minded to decision and impact assessment

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We are consulting on a set of proposed discounts to dis-incentivise inefficient bypass of the National Transmission System. We would like views from people with an interest in gas transmission charging. We particularly welcome responses from gas network users including producers, shippers, and all types of consumers. We would also welcome responses from other stakeholders.

This document outlines the scope, purpose and questions of the consultation and how you can get involved. Once the consultation is closed, we will consider all responses. We want to be transparent in our consultations. We will publish the non-confidential responses we receive alongside a decision on next steps on our website at [Ofgem.gov.uk/consultations](https://www.ofgem.gov.uk/consultations). If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential, and if possible, put the confidential material in separate appendices to your response.

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Executive summary

1.1. On 28 May 2020, we approved modification proposal UNC678A - Amendments to Gas Transmission Charging Regime (Postage Stamp). UNC678A introduced significant reforms to the Great Britain ("GB") gas transmission charging arrangements which became effective on 1 October 2020.

1.2. UNC678A removed the Optional Commodity Charge, which was available under the previous regime. The Optional Commodity Charge provided a discount to eligible users for transportation of gas with the aim of avoiding inefficient bypass of the National Transmission System ("NTS"). This was known in industry as "short-haul discount".

1.3. In our final UNC678A decision, we said that we said that: "the construction or usage of alternative network infrastructure to the NTS which leads to higher costs overall would not represent an efficient outcome. We welcome the industry's efforts, through the NTS Charging Methodology Forum ("NTS CMF"), to develop options for new short-haul arrangements that could be part of a TAR NC compliant transmission charging regime. Preventing inefficient bypass of the NTS, in a targeted, proportionate and compliant manner is, in our view, desirable. Ofgem is committed to working with the industry and the Joint Office of Gas Transporters to facilitate the development and, depending on the assessment and approval process, timely consideration and where appropriate implementation of modification(s) that seeks to address inefficient bypass of the NTS".¹

1.4. We have now been sent a set of five proposals (UNC728/A/B/C/D) that seek to introduce a discount to the gas transmission charging framework to dis-incentivise inefficient bypass of the NTS by directly connected NTS users located at close proximity to Entry Points ("short-haul").

1.5. We have considered all five UNC728 modification proposals presented to us for decision. Our principles based assessment has been supported by quantitative analysis carried out by CEPA and we have considered each modification proposal against the applicable UNC objectives and our statutory duties. We have also taken into account the full

¹ 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), page 3: <https://www.ofgem.gov.uk/publications-and-updates/amendments-gas-transmission-charging-regime-decision-and-final-impact-assessment-unc678abcdefghij>

range of information that has been made available to us, including the industry consultation under the UNC728 process, the views of the UNC Panel and the associated workgroup materials. Given that the bypass risk is highly route-specific, we have conducted a comprehensive assessment based on representations provided to us directly by various stakeholders, including some confidential evidence, as well as information that we have sought to assist us in making this decision.

1.6. Our assessment concludes that UNC728B better facilitates the applicable UNC objectives relative to the status quo and approving this modification proposal would be consistent with our principal objective and statutory duties. **Our minded to decision is to approve UNC728B.** UNC728B envisages a maximum discount of 90% and a minimum of 10% applied to transmission services charges for distances of up to 28 kilometers.

1.7. UNC728D may also better facilitate the applicable UNC objectives compared to the status quo and we consider that the very short distance cap proposed under this modification (ie 5km) has advantages. However, we consider that the proposed discount under this modification (ie 90% discount on Transmission Services charges and 94% on Non-Transmission Services charges) is too high for the purposes of dis-incentivising bypass. Having said that, when making our final decision, we will take into account any new information submitted to us. We expect stakeholders in support of UNC728D to provide robust evidence demonstrating that the proposed discount under UNC728B would not be sufficient to dis-incentivise bypass, with reference to capital and operational costs required for the construction and operation of a bypass pipeline as well as (where possible) a structural representation of any bypass pipeline(s) they are considering. We would also expect these stakeholders to show why bypass beyond 5km is not plausible. Similarly, we would expect any other interested party that would not be eligible for a discount under UNC728D, to provide evidence to demonstrate the credibility of any longer bypass pipeline.

1.8. Finally, we consider that UNC728/A/C would not better facilitate the applicable UNC objectives and approving any of these modification proposals would not be consistent with our principal objective and statutory duties. This includes the 18km distance cap which has no objective justification. We would expect any parties disagreeing with our assessment to provide evidence in support of their views.

1.9. In light of the assessment contained in this document, our minded-to decision is to approve 'UNC728B - Introduction of Conditional Discount for Avoiding Inefficient Bypass of the NTS with 28km distance cap'.

1. Introduction

What are we consulting on?

1.1. This consultation document incorporates our Impact Assessment ("**IA**") which assesses the impact that the Uniform Network Code ("**UNC**") modification proposals, submitted to us for decision, may have on consumers and industry participants, as well as any environmental impacts. This document also contains our proposed ("minded to") decision on the code modifications. We are seeking views and further evidence on both the IA and the minded to decision as part of our decision-making process.

1.2. We are required to make a decision on a set of proposals to change the UNC.² The proposals, discussed in this document, have been through an open industry workgroup process and consultation. As a result of the impact that the changes may have, we have decided to publish a minded to decision and IA, and to seek views on both.

1.3. We will take responses to this consultation into account when making our final decision, as well as the views from all relevant stakeholders, such as the industry, the UNC Panel, and those included in the UNC Final Modification Report ("**FMR**"). Following this consultation, we will make a final decision under the UNC Code Relevant Objectives and UNC Charging Methodology Objectives ("**CMRO**"), as well as our statutory duties.

1.4. The IA contained in Appendix 2 has been produced under section 5A of the Utilities Act 2000. We note that the quantitative modelling included in this IA is for the purposes of this decision only, and does not constitute an official Ofgem forecast of future network charges, energy costs or any other element. We would welcome views on this work and on any other analysis we should consider.

Ofgem's duties³

1.5. Ofgem's principal objective is to protect the interests of existing and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution or transmission systems.

² See Uniform Network Code modifications 728/A/B/C/D <https://www.gasgovernance.co.uk/0728>

³ Ofgem is the Office of the Gas and Electricity Markets Authority. The terms 'Ofgem', 'the Authority', 'we', 'our' and 'us' are used interchangeably in this document.

1.6. The interests of such consumers are their interests taken as a whole, including their interests in the reduction of greenhouse gases.

1.7. IAs are a tool to help explain the impact of regulatory proposals on consumers, industry participants, and social and environmental issues. Whilst IAs do not determine a final decision, they form a vital part of the decision-making process and provide a structured framework for understanding the impacts of our most important decisions.⁴

Section 2: Background

1.8. This section sets out the context and background for our minded to decision.

Section 3: Assessment against the applicable UNC objectives and our statutory duties

1.9. In this section, we present our assessment of the proposed modifications against the applicable UNC objectives.

Section 4: Conclusion – Minded to decision

1.10. In this section, we present our minded to decision and rationale based on the assessment presented in the previous section and the quantitative analysis we have undertaken. We also summarise the next steps, including our expectations surrounding implementation of the final decision.

Context and related publications

1.11. This consultation concerns a set of proposals (UNC728/A/B/C/D) to introduce a discount to transmission tariffs for short-distance transportation of gas (short-haul) with the aim of dis-incentivising inefficient bypass of the National Transmission System (“NTS”).

⁴ See Impact Assessment Guidance (4 May 2020) <https://www.ofgem.gov.uk/publications-and-updates/impact-assessment-guidance>

1.12. All materials and analysis related to UNC728/A/B/C/D can be accessed at the following dedicated link on the website of the Joint Office of Gas Transporters:

<https://www.gasgovernance.co.uk/0728>

1.13. Moreover, on 28 May 2020 we approved modification proposal UNC678A – ‘Amendments to Gas Transmission Charging Regime (Postage Stamp)’⁵ and decided that it should be implemented 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**”).⁶ Our final decision to approve UNC678A followed a two month consultation period as required by Articles 26 and 28 TAR NC.⁷

Consultation stages

1.14. We are publishing this consultation on **Friday 22 January 2021**. The consultation shall be open for **four weeks**. Responses to this consultation must be sent to Gas.TransmissionResponse@ofgem.gov.uk by **Friday 19 February 2021**.

1.15. We will publish all non-confidential responses submitted to us when we make our final decision.

How to respond

1.16. We want to hear from anyone interested in this consultation. As part of this consultation exercise, we have posed a number of questions (listed in Appendix 1) to assist consultees in providing representations, information and evidence to us in response to our minded to decision. These questions are intended to guide responses, but do not prevent

⁵ 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-and-updates/amendments-gas-transmission-charging-regime-decision-and-final-impact-assessment-unc678abcdefghij>

⁶ 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.

⁷ All materials relating to this consultation can be accessed at: <https://www.ofgem.gov.uk/publications-and-updates/amendments-gas-transmission-charging-regime-minded-decision-and-draft-impact-assessment>

consultees raising other matters which are considered to be material to our final decision. Please send your response to the person or team named on this document's front page.

1.17. We've asked for your feedback in each of the questions throughout. Please respond to each one as fully as you can.

1.18. We will publish non-confidential responses on our website at www.ofgem.gov.uk/consultations.

Your response, data and confidentiality

1.19. You can ask us to keep your response, or parts of your response, confidential. We'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.

1.20. If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.

1.21. If the information you give in your response contains personal data under the General Data Protection Regulation 2016/379 (GDPR) and domestic legislation on data protection, the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 3.

1.22. If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

General feedback

1.23. We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Any further comments?

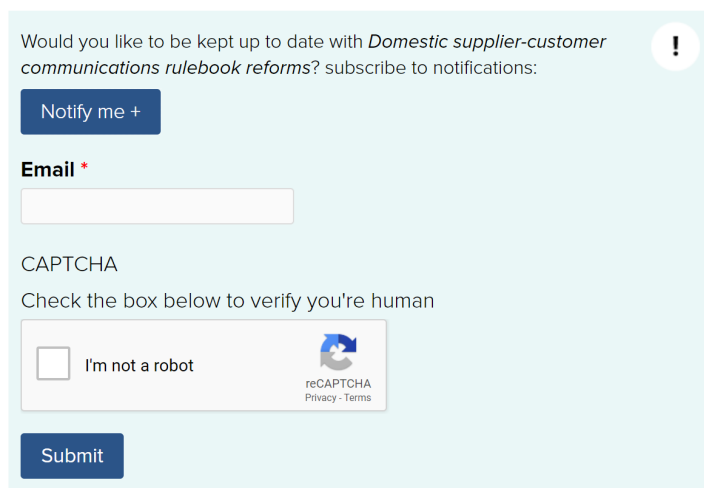
Please send any general feedback comments to stakeholders@ofgem.gov.uk


How to track the progress of the consultation

You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website.

[Ofgem.gov.uk/consultations](https://www.ofgem.gov.uk/consultations).

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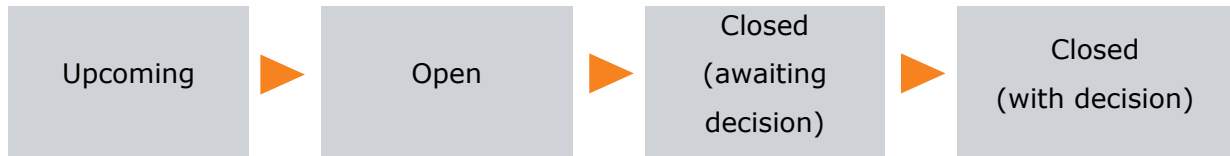
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Once subscribed to the notifications for a particular consultation, you will receive an email to notify you when it has changed status. Our consultation stages are:



2. Background

Section summary

This section sets out the context and background for our minded to decision.

Introduction

2.1. On 28 May 2020, we approved modification proposal UNC678A – ‘Amendments to Gas Transmission Charging Regime (Postage Stamp)’⁸ and decided that it should be implemented on 1 October 2020. In our decision, we noted that: “the construction or usage of alternative network infrastructure to the NTS which leads to higher costs overall would not represent an efficient outcome. We welcome the industry’s efforts, through the NTS Charging Methodology Forum (“**NTS CMF**”), to develop options for new short-haul arrangements that could be part of a TAR NC compliant transmission charging regime. Preventing inefficient bypass of the NTS, in a targeted, proportionate and compliant manner is, in our view, desirable. Ofgem is committed to working with the industry and the Joint Office of Gas Transporters to facilitate the development and, depending on the assessment and approval process, timely consideration and where appropriate implementation of modification(s) that seeks to address inefficient bypass of the NTS”.

2.2. On 9 June 2020, National Grid Gas Transmission (“**NGGT**”) raised UNC728 - ‘Introduction of a Conditional Discount for Avoiding Inefficient Bypass of the NTS’ and requested that it should be treated as urgent and proceed under a timetable approved by the Authority. UNC728 proposes to introduce a discount for dis-incentivising inefficient bypass of the NTS.⁹ The discount is proposed to be available to directly connected NTS users located at

⁸ 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-and-updates/amendments-gas-transmission-charging-regime-decision-and-final-impact-assessment-unc678abcdefghij>

⁹ The UNC728 modifications state that “...there remains an enduring need for the prospective Charging Methodology to include bespoke charging arrangements to ensure the efficient use of the network, in this case to avoid inefficient bypass of the NTS by large consumers located close to points of entry to the NTS”. Also UNC670R Workgroup noted that: “Inefficient bypass is defined in this context from the existing network perspective. The construction and use of independent pipelines bypassing the NTS risks increased costs as they are spread over a smaller base”;

or near NTS entry points. Four more alternatives proposals (UNC728A/B/C/D) were submitted to the Joint Office on the same day. On 12 June 2020, we decided to grant urgent status for UNC728/A/B/C/D.¹⁰

2.3. On 3 July 2020, UNC Panel Members recommended that UNC modifications 728/A/B/C/D should not be implemented. Modifications UNC728/A/B/C/D were then sent to us for decision. On 16 July 2020, we published a letter stating that we will carry out an IA to explore the impacts arising from the above modifications.¹¹ As part of our IA, we commissioned CEPA to undertake modelling of the options. We are publishing CEPA's analytical report as a subsidiary document to this consultation.

The UNC728/A/B/C/D modifications

2.4. We are required to make a decision to approve or reject UNC728/A/B/C/D (referred to collectively as 'UNC728 modifications'). In total five modification options have been submitted to us for consideration. While each modification shares a number of common attributes, they each have some particular characteristics which require careful consideration which are explained below and are summarised in Table 1 at the end of this section.

- **Eligible distance:** the different alternatives propose distance caps between 5km and 28km.
- **Transmission vs. non-transmission services charges¹²:** UNC728/B/C envisage that the discount be applied to transmission services charges only. UNC728A/D on the other hand envisage that the discount be applied both to transmission and non-transmission services charges (ie the General Non-Transmission Services Entry and Exit Charges – "GNTS" entry and exit charges).

<https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2019-08/Request%20Workgroup%20Report%200670R%20v1.0.pdf>

¹⁰ UNC728/A/B/C/D Introduction of a Conditional Discount for Avoiding Inefficient Bypass of the NTS: Urgency Application (12 June 2020) <https://www.ofgem.gov.uk/publications-and-updates/unc728abcd-introduction-conditional-discount-avoiding-inefficient-bypass-nts-urgency-application>

¹¹ Uniform Network Code 728/A/B/C/D (Urgent) - Introduction of a Conditional Discount for Avoiding Inefficient Bypass of the NTS (16 July 2020) <https://www.ofgem.gov.uk/publications-and-updates/uniform-network-code-728abcd-urgent-introduction-conditional-discount-avoiding-inefficient-bypass-nts>

¹² The definition of 'transmission tariffs' and 'non-transmission tariffs' are provided in Article 3 TAR NC.

- **Determination of eligible quantities:** UNC728C proposes that the transmission-services charges discount will be applied on the lower of entry and exit firm capacity bookings (less any "existing contract capacity"¹³). The other four modifications (UNC728/A/B/D) propose that the eligible quantities for the transmission-services charges discount will be calculated on the basis of the minimum of four values (less any existing contract capacity): (i) firm capacity at entry; (ii) firm capacity at exit; (iii) flow at entry; and (iv) flow at exit. For any volumes in excess of the eligible quantities, these will pay the standard (non-discounted) charges applicable. Finally, the two modifications that envisage a discount to non-transmission services charges (UNC728A/D) propose that the eligible quantities for the GNTS charges discount will be the lower between entry flows and exit flows.
- **Level of discount:** UNC728/A/B/C envisage a maximum discount of 90% and a minimum of 10% applied to transmission services charges. UNC728D proposes a 90% discount on transmission services charges for all eligible routes. Finally, the two modification that contain a discount on non-transmission services charges (UNC728A/D) propose an 80% and 94% discount respectively on GNTS charges.

¹³ "Existing contracts" are capacity bookings concluded before 6 April 2017 which fall within the scope of Article 35 Commission Regulation (EU) 2017/460 of 16 March 2017 establishing a network code on harmonised transmission tariff structures for gas ("**TAR NC**").

Table 1 - Comparison Table for Modifications UNC728/A/B/C/D (source: UNC728/A/B/C/D Final Modification Report)¹⁴

		728	728A	728B	728C	728D
		v1.0 (4/6/2020)	v1.0 (4/6/2020)	v1.0 (4/6/2020)	v1.0 (4/3/2020)	v1.0 (4/3/2020)
Charge group	Element	National Grid	South Hook Gas Company	Vitol SA Geneva	RWE	ENI Trading & Shipping
Transmission Services Discount	Charge which the discount is applied to	Entry Capacity Reserve Price and Exit Capacity Reserve Price	Entry Capacity Reserve Price and Exit Capacity Reserve Price	Entry Capacity Reserve Price and Exit Capacity Reserve Price	Entry Capacity Reserve Price and Exit Capacity Reserve Price	Entry Capacity Reserve Price and Exit Capacity Reserve Price
	Eligible Distance (km)	18	18	28	18	5
	Discount (%)	90% (at 0km) - 10% (at 18km)	90% (at 0km) - 10% (at 18km)	90% (at 0km) - 10% (at 28km)	90% (at 0km) - 10% (at 18km)	Standard 90% discount for all eligible routes
	Initial Eligible Quantity (Entry)	(Lower of Entry Capacity, Exit Capacity, Entry Allocation, Exit Allocation) less any Existing Contract Capacity	(Lower of Entry Capacity, Exit Capacity, Entry Allocation, Exit Allocation) less any Existing Contract Capacity	(Lower of Entry Capacity, Exit Capacity, Entry Allocation, Exit Allocation) less any Existing Contract Capacity	(Lower of Entry Capacity, Exit Capacity) less any Existing Contract Capacity	(Lower of Entry Capacity, Exit Capacity, Entry Allocation, Exit Allocation) less any Existing Contract Capacity
	Initial Eligible Quantity (Exit)	Lower of Entry Capacity, Exit Capacity, Entry Allocation, Exit Allocation	Lower of Entry Capacity, Exit Capacity, Entry Allocation, Exit Allocation	Lower of Entry Capacity, Exit Capacity, Entry Allocation, Exit Allocation	Lower of Entry Capacity, Exit Capacity	Lower of Entry Capacity, Exit Capacity, Entry Allocation, Exit Allocation
Non-Transmission Services Discount	Charge which the discount is applied to	N/A	General Non-Transmission Services Charge	N/A	N/A	General Non-Transmission Services Charge
	Discount (%)	N/A	80	N/A	N/A	94
	Eligible Quantity	N/A	Lower of Entry Allocation, Exit Allocation	N/A	N/A	Lower of Entry Allocation, Exit Allocation

Variation in treatment of element from UNC Modification Proposal UNC728

¹⁴ Final Modification Report UNC728/A/B/C/D, Appendix 3 available at: <https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2020-07/Final%20Modification%20Report%200728ABCD%20%28Urgent%29%20v3.0.pdf> The original table did not provide the applicable transmission services discount (%) but we have added this item in Table 1 above to assist readers.

3. Assessment against the applicable UNC objectives and our statutory duties

Section summary

In this section, we present our assessment of the proposed modifications against the applicable UNC objectives and our statutory duties.

Questions

Please provide evidence and analysis to support your responses.

Question 1: Do you agree with our assessment of the modification options against the applicable UNC objectives? If you disagree, please provide a fully reasoned explanation.

Question 2: What are your views on our conclusion that the proposed modification proposals constitute a 'benchmarking' adjustment to the application of the reference price methodology (Article 6(4) TAR NC)? If you disagree, please provide a fully reasoned explanation.

Question 3: Do you agree with our assessment of the quantitative analysis? If you disagree, please provide a fully reasoned explanation.

Question 4: Do you agree with our assessment that UNC728C is discriminatory because of the risk that the discount may be used for a route other than a qualifying nominated route? If you disagree, please provide a fully reasoned explanation.

Question 5: Do you agree with our assessment of the modification options against our statutory duties? If you disagree, please provide a fully reasoned explanation.

3.1. In this section, we present our assessment of the proposed modifications against the applicable UNC objectives and our statutory duties. Our assessment is supported by the quantitative analysis undertaken by CEPA, to which we make references. CEPA's full quantitative results and a description of the methodology and assumptions are presented in CEPA's Analytical Report which is published as a subsidiary document to this consultation.

3.2. All modification options other than UNC728C were modelled by CEPA. UNC728C is identical to UNC728 in all aspects other than the determination of eligible quantities. We have considered that the quantitative impacts would be similar between these two modifications and asked CEPA to conduct an additional tariff sensitivity which assumes a level of

overbooking under UNC728C. The full results of the additional tariff sensitivity presented in the CEPA Analytical Report that we publish as a subsidiary document to this consultation.¹⁵ We had informed industry of this approach during the 6 October 2020 NTS CMF meeting.¹⁶ In the next sub-section, we assess all UNC728 modifications (including UNC728C) against the applicable UNC objectives.

Assessment against the applicable UNC objectives

3.3. 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.

3.4. We consider that UNC728/A/C have a negative impact on UNC Relevant Code Objectives (a), (c), (d) and (g), and on UNC CMROs (b), (a), (c), (aa), and (e). UNC728B/D both better facilitate UNC Relevant Code Objectives (a) and (c), and UNC CMROs (b) and (a) and have a neutral impact on UNC Relevant Code Objective (g) and UNC CMRO (e) relative to the status quo, while UNC728B will better facilitate these objectives than UNC728D. UNC728B will have a neutral impact on UNC Relevant Code Objective (d), and UNC CMROs (c) and (aa), while UNC728D will have a negative impact on these objectives. All proposals will have a neutral impact on UNC Relevant Code Objective (f). Finally, we consider that UNC Relevant Code Objectives (b), (e) and UNC CMRO (d) are not relevant to any of the modification proposals.

Objective (a) Efficient and economic operation of the pipe-line system and CMRO Objective (b) that, so far as is consistent with sub-paragraph (a), the charging methodology properly takes account of developments in the transportation business

3.5. We consider that UNC728D and UNC728B better facilitate UNC Relevant Code Objective (a) and UNC CMRO (b) relative to the status quo, while UNC728/A/C have a negative impact on these objectives. We also consider that UNC728B better facilitates the relevant code objectives compared to UNC728D for the reasons explained below.

¹⁵ CEPA Analytical Report, §3.6.

¹⁶ https://www.gasgovernance.co.uk/sites/default/files/ggf/2020-11/Minutes%20NTSCMF%2006Oct2020%20v2.0_0.pdf

3.6. In our UNC678A decision we said that: “to the extent that a [short-haul discount] is well targeted at network users who present a credible risk of bypass and provides a proportionate discount, we believe that the benefits for network efficiency could outweigh the disbenefits”.¹⁷

3.7. As part of our IA on UNC728/A/B/C/D, we asked CEPA to estimate the number of routes that their modelling suggests present a risk of bypass under each option. CEPA’s estimates are presented in Table 2 below.

Table 2 - Number of routes that present a risk of bypass assuming a five-year payback time based on CEPA’s modelling (CT, 2030-31)

Tariff option	Number of routes that present a credible risk of bypass
Status quo	12
UNC728	10
UNC728A	6
UNC728B	10
UNC728D	3

3.8. CEPA noted that their modelling of bypass represents an overestimate of the likelihood of bypass risk by design. That is because CEPA’s bypass estimate cannot include a number of cost areas that are very difficult to establish: for example, those relating to use of land, legal costs, or risks associated with supply or network constraints over the gas pipeline. It also excludes factors that could increase the risk of bypass in some cases, such as the ability of ‘clusters’ of neighbouring exit points to collectively bypass the network.¹⁸

3.9. We have received confidential representations from several stakeholders that indicate the actual likelihood of bypass is likely to be highly site-specific. For that reason, we have carried out a holistic route-specific assessment of the risk of bypass, based on confidential stakeholder evidence, CEPA’s quantitative analysis, publically available evidence (including responses to relevant consultations) and qualitative considerations. We have considered a number of relevant factors, such as distance, pipeline size, nature of use and geography. Based on our assessment we identified **eight routes** that in our view may present a varying

¹⁷ UNC678A final decision (28 May 2020), page 24.

¹⁸ We asked CEPA to also model three potential groups of exit points that stakeholders have suggested to us that they may consider to bypass collectively; see CEPA Analytical Report, §4.4.

degree of risk of bypass under the status quo ('higher' or 'medium' risks). In addition, we identified three more routes that we consider would pose a 'lower' risk of bypass.

3.10. UNC728/A/C propose a varying discount for transmission services charges which falls as the distance increases. Such a discount structure provides an appropriate risk-based response to the bypass problem, which is inherently subject to significant uncertainty. However, we consider that UNC728/A/C have not justified their 18km distance cap. All of the identified 'higher risks' of bypass are captured by the 5km distance cap proposed under UNC728D. In addition, we consider that the routes falling between 5km and 18km pose a lower risk of bypass, so the proposed distance cap provides no or very little added value for the purposes of dis-incentivising inefficient bypass relative to the shorter 5km distance cap. In addition, we have also identified a number of 'medium' and 'lower' risks that fall outside the 18km distance cap and are captured by the 28km modification (UNC728B). As a result of these factors, some relatively lower risk routes would be eligible for a discount under the 18km modifications, while some relatively higher risk routes would not be eligible, despite only being marginally outside the proposed distance cap. This is acknowledged by the proposers of UNC728/A/C who have plotted the ratio of bypass costs to NTS usage costs in their modifications.¹⁹ Therefore, we consider that the 18km distance cap has the weakest justification among the UNC728 modifications.

3.11. The proposed 5km distance cap under UNC728D targets the vast majority of routes that are identified as risks under CEPA's analysis and all of the routes that we have classified as 'higher' risks. Therefore, we consider that UNC728D is the option that is best-targeted at network users who present a higher risk of bypass. UNC728D does not capture a number of lower and medium risk routes that may bypass under the status quo or if UNC728D were to be implemented. Nevertheless, a short-haul discount should be proportionate to the risk of bypass and not necessarily attempt to eliminate all risk of bypass which could lead to excessively generous availability and discounts, which wouldn't ultimately be in the best interests of consumers. We think that a very short distance cap of 5km has significant advantages. However, we consider that the proposed discount under UNC728D is too generous for the purposes of dis-incentivising bypass. UNC728D proposes that eligible users

¹⁹ See Figure 1 ("Likelihood of bypass") in UNC728/A/C Final Modification Reports. This figure suggests that there are routes just outside the 18km distance cap that would pose a similar or even more serious degree of risk compared to those falling within the 18km eligible distance. Nevertheless, the proposers state that: "...the ratios suggest that no User beyond 17.7km would consider investing the time, effort and capital required to bypass when the benefits over ten years are not significant". The proposers do not otherwise justify the proposed distance cap.

would receive a flat 90% discount on transmission services charges and a discount of 94% on non-transmission services charges. Based on our assessment we are not satisfied that this level of discount is necessary for dis-incentivising inefficient bypass.

3.12. UNC728B proposes the longest distance cap (28km). However, we consider that the eligible distance under UNC728B is better-justified compared to the 18km modifications. UNC728B provides discounts to routes that pose a similar degree of risk. Despite the length of the proposed distance cap, there are advantages to UNC728B. This modification provides higher discounts for the short-distance routes that present a 'higher' risk of bypass, while it affords lower discounts to longer-distance routes which are proportionate to the lower risk presented by those routes.

3.13. As described in section 2, three modifications (UNC728/B/C) propose that the discount only be applied to transmission services charges, whereas two modifications (UNC728/A/D) propose that the discount be applied to both transmission services charges and non-transmission services charges. Our assessment set out above is driven by whether the total (effective) level of the discount is appropriate (ie sufficient to dis-incentivise inefficient bypass without offering an undue cross-subsidy) rather than on which element of the overall tariff the discount is applied to.

3.14. Any assessment on the risk of bypass is necessarily subject to many uncertainties and depends on route-specific considerations. As part of our consultation, we invite and encourage interested stakeholders to share with us evidence relating to the risk of bypass, including any views backed up by specific evidence on the appropriate discount level and eligible distance.

Objective (c) Efficient discharge of the licensees' obligations and CMRO Objective (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

3.15. In the context of this decision, the licensee (ie NGGT) has an obligation to achieve certain objectives including cost reflectivity and non-discrimination. In our UNC678A decision, we said that 'preventing inefficient bypass of the NTS, in a targeted, proportionate and compliant manner is, in our view, desirable'.

3.16. As stated above, the 18km proposals (UNC728/A/C) do not provide a strong justification for the proposed distance cap. For this reason, we consider that these

modifications would introduce an unjustified discrimination between routes eligible for the discount and routes just outside the distance cap that are not eligible for the discount even though they pose a similar or greater risk of bypass. We have also identified a specific compliance issue in relation to UNC728C, which is described below (under UNC Relevant Code Objective (g) and UNC CMRO (e)).

3.17. UNC728D has the shortest eligible distance (5km) and captures all routes that we consider pose a 'higher' risk of bypass. Nevertheless, based on the information available to us, our view is that the proposed discount under this modification goes beyond the minimum necessary to dis-incentivise bypass.

3.18. Finally, UNC728B proposes the longest distance cap but does not lead to discriminatory outcomes, as is the case with the 18km modifications (UNC728/A/C). UNC728B proposes a distance cap significantly longer than the 5km distance (where the 'higher' risks are located) but has the benefit of providing higher discounts for the short-distance routes that present a 'higher' risk of bypass, while it affords lower discounts to longer-distance routes which are proportionate to the risk of bypass presented by those routes.

3.19. For these reasons, we consider that UNC728D and UNC728B better facilitate UNC Relevant Code Objective (c) and UNC CMRO (a) relative to the status quo, while UNC728/A/C would have a negative impact on these objectives. We also consider that UNC728B better facilitates the relevant code objectives compared to UNC728D.

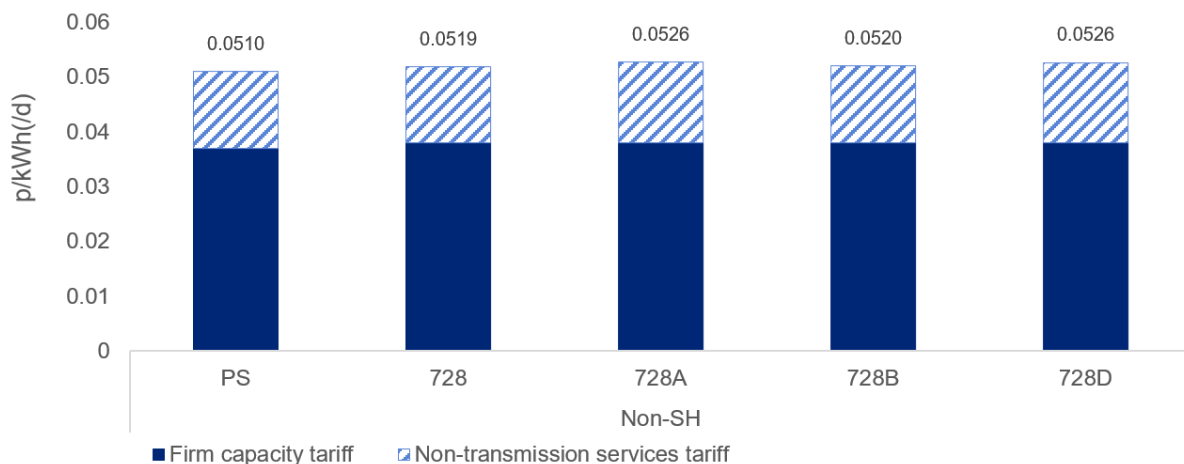
Objective (d) Securing of effective competition and CMRO Objective (c) that, so far as is consistent with sub-paragraphs (a) and (b), compliance with the charging methodology facilitates effective competition between gas shippers and between gas suppliers, and CMRO Objective (aa) that, in so far as prices 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

3.20. In our UNC678A final decision, we said that: "In general, competition is best facilitated by tariff arrangements which are cost-reflective and non-discriminatory. However, in a meshed network largely operating below capacity with expected declining demand, the main consideration is the appropriate and fair recovery of costs that is not likely to lead to inefficient behaviour and distortions".

3.21. We consider that the 18km modifications (UNC728/A/C) lead to discriminatory outcomes, for the reasons noted previously. Specifically, they allow discounts for some routes that represent a lower risk of bypass while not allowing discounts for other routes with a higher risk of bypass.

Despite its narrower eligibility criteria, UNC728D provides the highest discount for eligible routes under the UNC728 modifications. As shown in Figure 1 below (taking the central Consumer Transformation scenario), UNC728D and UNC728A lead to the highest exit tariff for users not eligible for the short-haul discount. This figure only considers 'first order' effects (ie assumes that all existing users of the gas network remain on the system).²⁰

Figure 1 - Exit tariffs for non-shorthaul users (CT, 2030-31, £18/19, source: CEPA Analytical Report)



3.22. As a result of these features, UNC728D would have an upward effect on tariffs for non-eligible users while affording a very high discount to eligible users.²¹ Any discount which is afforded to some users but not others will necessarily give rise to a cross-subsidy. As stated in our UNC678 IA,²² the theoretical optimum would be to reduce the number of routes which

²⁰ CEPA modelled 32 eligible routes under UNC728B, 24 routes under UNC728/A and 22 routes under UNC728D.

²¹ See CEPA Analytical Report for detailed results. CEPA has calculated 'first order tariff effects' (which assume that all users of the NTS will remain on the network) as well as 'second order tariff effects' (which are based on certain assumptions of bypass).

²² See UNC678/A/B/C/D/E/F/G/H/I/J Final Impact Assessment (28 May 2020), page 40 <https://www.ofgem.gov.uk/publications-and-updates/amendments-gas-transmission-charging-regime-decision-and-final-impact-assessment-unc678abcdefghij>

continue to present a credible bypass risk, while minimising the amount of discount that is provided to achieve this.²³ The amount of discount provided to achieve zero credible bypass cannot be completely reduced to zero as some discount will always be required to prevent bypass, resulting in lost revenue. However, we consider that the discount under UNC728D goes beyond the minimum necessary to dis-incentivise bypass. Without further evidence demonstrating that the level of discount proposed under UNC728D is necessary to dis-incentivise bypass we therefore conclude that UNC728D has a negative impact on competition. However, we will take into account any further representations on this issue made to us in the course of the consultation process. Finally, we note that CEPA's modelling observed one route which falls outside the 5km distance cap that does not pose a risk of bypass under the status quo but does so under UNC728D. While we think this particular case may be an over-estimate of bypass, it nevertheless demonstrates the potential distortive impacts of an excessively high discount.

3.23. Finally, we consider that UNC728B would have a neutral impact on competition. While we recognise that UNC728B would also give rise to a cross-subsidy, we nevertheless consider that this cross-subsidy is broadly proportionate to the risk of bypass posed by the eligible routes.

3.24. For the reasons set out above, we consider that UNC728B would have a neutral impact on UNC Relevant Code Objective (d) and UNC CMRO (c) and (aa) relative to the status quo, whereas UNC728/A/C/D would have a negative impact on these objectives.

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

²³ We are also conscious that due to the existence of a significant volume of existing contracts which are due to expire in the coming years (Article 35 TAR NC), any under-recovery of the Transmission Services revenue caused by the UNC728 modifications will be levied on a narrower base of entry capacity. CEPA found that UNC728A and UNC728D would lead to the highest entry tariff for non-shorthaul users (CEPA Analytical Report, §3.2.1).

3.25. Before assessing UNC Relevant Code Objective (g) and UNC CMRO (e), it is necessary to consider how the proposed UNC728/A/B/C/D modifications fit within the overall scheme of TAR NC.

3.26. Article 6(4)(a) TAR NC provides that: "Adjustments to the application of the reference price methodology to all entry and exit points may only be made in accordance with Article 9 or as a result of one or more of the following: (a) **benchmarking** by the national regulatory authority, whereby reference prices at a given entry or exit point are adjusted so that the resulting values meet the competitive level of reference prices".

3.27. Article 6(4) TAR NC allows adjustments to the application of the reference price methodology with the purpose of meeting "the competitive level of reference prices". In cases where bypass is possible, the creation of a competing bypass pipeline would impact on the competitive level of reference prices. In the absence of benchmarking, there is a risk of bypass pipelines being built. In such a case, the competitive level of reference prices is determined not by reference of the cost of an existing competing pipeline but rather by reference of the cost of a pipeline that could be built if the non-benchmark tariffs were applied. We are aware of at least one example in the European Union where the benchmarking adjustment has been applied in such way.²⁴

3.28. The compliance of the proposed adjustments under UNC728/A/B/C/D with Article 6(4)(a) TAR NC depends on two questions: (i) whether the proposed adjustments apply to routes that pose a credible risk of bypass; and (ii) whether the benchmarking adjustment is set at the appropriate level to "meet the competitive level of reference prices". Where the adjustment would apply to routes that do not pose a credible risk of bypass or where the discount would be inappropriately high or low to dis-incentivise bypass of the NTS, then the criteria of Article 6(4)(a) TAR NC would not be satisfied. We do not think this provision imposes a requirement that the adjusted values exactly match the competitive level of reference prices, since such calculation is subject to many uncertainties and likely depends on the specific methodology employed to approximate the competitive level of reference prices.

²⁴ See Agency for the Cooperation of Energy Regulators ("ACER"), Agency report - 2nd analysis of the consultation document for Germany (17/07/2020) https://acer.europa.eu/en/Gas/Framework%20guidelines_and_network%20codes/Pages/Harmonised-transmission-tariff-structures.aspx

However, any methodology must provide a reasonable relationship between the resulting values and the competitive level of references prices.

3.29. UNC728D has the benefit of proposing the shortest distance cap while capturing all routes that we have classified as posing a 'higher' risk of bypass. Therefore, UNC728D satisfies the first criterion noted in the previous paragraph (ie the proposed adjustments apply to routes that pose a credible risk of bypass). We consider that the proposed discount under UNC728D (ie 90% on transmission services charges and 94% on non-transmission services charges) goes beyond the minimum necessary to dis-incentivise bypass. This would indicate that UNC728D may not satisfy the second criterion. Subject to this point, on balance, we consider UNC728D to have a neutral impact on compliance. However, given the proposed high level of discount and flat rate under UNC728D, where stakeholders disagree with our view, we would expect them to submit evidence as part of our consultation, demonstrating that there is indeed a reasonable relationship between the resulting values and the "competitive level of references prices", in order for us to consider approving the modification.

3.30. The 18km modifications demonstrate a reasonable relationship between the proposed transmission services discount and the competitive level of references prices. However, we consider that the proposed distance is unduly discriminatory for the reasons explained below.

3.31. Regarding UNC728B, we consider that the proposed discount (ie ranging from 90% to 10% and applied to transmission services charges) demonstrates a reasonable relationship between the resulting values and the competitive level of references prices.

3.32. Gas transmission charging arrangements must also be compliant with the general tariff requirements set out in TAR NC and 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 ("**Gas Regulation**").²⁵ Among other things, TAR NC and the Gas Regulation set out the legal requirements that tariffs will comply with the principle of non-discrimination while avoiding undue cross-subsidies.

²⁵ Now incorporated in UK law in accordance with the European Union (Withdrawal) Act 2018 as amended by the European Union (Withdrawal Agreement) Act 2020.

3.33. Regarding the principle of non-discrimination, we consider that under the 18km modifications (UNC728/A/C) some relatively lower risk routes would be eligible for a discount, while some relatively higher risk routes would not be eligible, despite only being marginally longer than the proposed distance cap. This suggests that the proposed distance cap involves a difference in treatment, without objective and proportionate justification. We consider that, as a result these modifications involve undue discrimination.

3.34. It was highlighted during the UNC consultation that UNC728C may be at odds with the principle of non-discrimination due to its particular features. As noted previously, UNC728C is identical to UNC728 in all aspects other than the determination of eligible quantities. These differences were explained in detail in section 2. Specifically, the discount under UNC728C would apply to capacity bookings regardless of whether and how these capacity bookings would be utilised. On the other hand, the discount under UNC728/A/B/D would apply to capacity bookings only insofar as these bookings are utilised at the nominated entry and exit points. We consider that UNC728C carries the risk that the discount may not be used as intended by the UNC728 modifications; namely, for the narrow purposes of “meeting the competitive level of reference prices” and dis-incentivising inefficient bypass. Specifically, it is conceivable that a user may book discounted entry and exit capacity under UNC728C and then use either or both of these for a route other than the one identified as being at risk of bypass. UNC728C would also carry the risk of allowing users to use discounted entry and/or exit capacity for routes exceeding the proposed 18km distance cap. If this risk were to materialise, UNC728C would breach the principle of non-discrimination as it would provide discounts to some users but not others for the same service of gas transmission, without objective and proportionate justification.

3.35. Finally, we note that in the context of the proposed modifications, the assessment of whether UNC728/A/B/C/D give rise to an “undue” cross-subsidy involves very similar considerations to the preceding compliance assessment regarding Article 6(4)(a). Specifically, UNC728D has the narrower eligibility criteria which would indicate that it minimises the cross-subsidisation in that regard. At the same time, however, the proposed discount under UNC728D goes beyond the minimum necessary to dis-incentivise bypass. The remaining modifications (UNC728/A/B/C) demonstrate a reasonable relationship between the proposed Transmission Services discount and the competitive level of reference prices. However, the determination of eligible routes under the 18km modifications (UNC728/A/C) is not objectively justified, which indicates that the resulting cross-subsidy is ‘undue’.

3.36. In conclusion, we consider that UNC728B/D have a neutral impact on UNC Relevant Code Objective (g) and UNC CMRO (e) but we note our preference for UNC728B as it

benchmarks more closely to the costs of an alternative pipeline. However, we would expect interested parties to provide evidence demonstrating that UNC728D complies with the legal requirements set out above, before we are able to definitively conclude in our final decision that UNC728D is compliant with legal requirements. We consider that UNC728/A/C would have a negative impact on these objectives.

Objective (f) Promotion of efficiency in the implementation and administration of the code

3.37. We consider the impacts of the proposed modifications on the efficiency in the implementation and administration of the code to be relatively small. We note that the introduction of a benchmarking adjustment (under Article 6(4) TAR NC) in GB would inevitably add complexity to the implementation and administration of the code. However, this complexity is mitigated by the transparent manner in which the proposed discounts and eligibility criteria have been set out under UNC728/A/B/C/D. Overall, we consider that UNC728/A/B/C/D would have a neutral impact on UNC Relevant Code Objective (f).

Assessment against our principal objective and statutory duties

3.38. In this sub-section, we are considering whether approving any of the modifications would be consistent with our principal objective and statutory duties.²⁶ The Authority's principal objective is to protect the interests of existing and future consumers in relation to gas conveyed through pipes, including their interests in the reduction of greenhouse gases.

Gas market consumer welfare impacts

3.39. The proposed UNC728 modifications seek to address the risk of certain users bypassing the NTS to avoid paying the transmission tariff. If this risk were to materialise, this would reduce the amount of capacity contributing to recovery of allowed revenue. This would have an upward effect on transmission tariffs for remaining users of the NTS. On the other hand, any discount designed to dis-incentivise bypass would give rise to a cross-subsidy and increase transmission tariffs for non-eligible users. For this reason, any short-haul discount

²⁶ 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.

must be well-targeted and set at the minimum level required to dis-incentivise inefficient bypass.

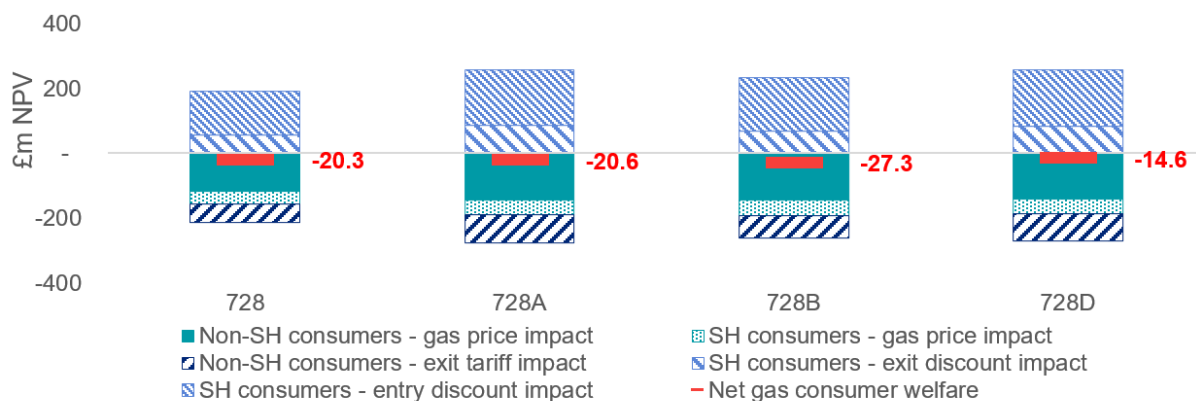
3.40. We asked CEPA to consider the first order effects and the second order effects of the UNC728 modifications. CEPA's first order effects analysis assumes that all existing users of the gas network remain on the system. However, given that the purpose of the UNC728 modifications is to dis-incentivise bypass, we considered it appropriate to also assess the second order effects of the options. The second order effects analysis assesses the potential for a short-haul discount to prevent bypass, ensure revenue recovery from a greater volume of capacity and avoid an associated increase in tariffs for those who remain connected to the NTS. The first order and second order effects results are presented in detail in CEPA's Analytical Report published alongside this consultation. We focus on the second order effects here which are relevant to our minded-to decision.

3.41. CEPA note that the second order effects are subject to a greater level of uncertainty given the inherent challenges involved in modelling commercial bypass decisions. Given this uncertainty, we asked CEPA to consider two bypass sensitivities: (i) a high bypass sensitivity; and (ii) a low bypass sensitivity. Under the 'high bypass sensitivity', CEPA has assumed that all routes choose to bypass where the modelling indicates that they may profitably do so. As explained previously, this approach is likely to result in an over-estimate of the risk of bypass given that it does not account for a number of cost areas that a private operator would consider before deciding to invest in a bypass pipeline. For that reason, we requested CEPA to consider a 'low bypass sensitivity' which is based on our qualitative holistic assessment of the risk of bypass. For the low bypass sensitivity, we asked CEPA to focus on the status quo and UNC728B and UNC728D, given that UNC728/A/C modifications have a negative impact on the UNC objectives assessed above and, specifically, given that we consider the 18km distance cap to be discriminatory. Under the low bypass sensitivity, we have identified eight routes that we consider to be at risk of bypass under the status quo.²⁷ Under both UNC728B and UNC728D, our analysis suggests that two routes would remain at risk of bypass. The specific routes at risk of bypass are different for each of the options. This analysis has been based on the best information available to us, including commercially sensitive evidence submitted to us by stakeholders.

²⁷ In addition to those eight routes, we have identified an additional number of 'lower risk' routes.

3.42. First, when considering the first order effects, CEPA's modelling identified a small negative Net Present Value ("**NPV**") of the gas market consumer welfare impact under the Consumer Transformation scenario between the years 2022 and 2031 under UNC728/A/B/D relative to the status quo.

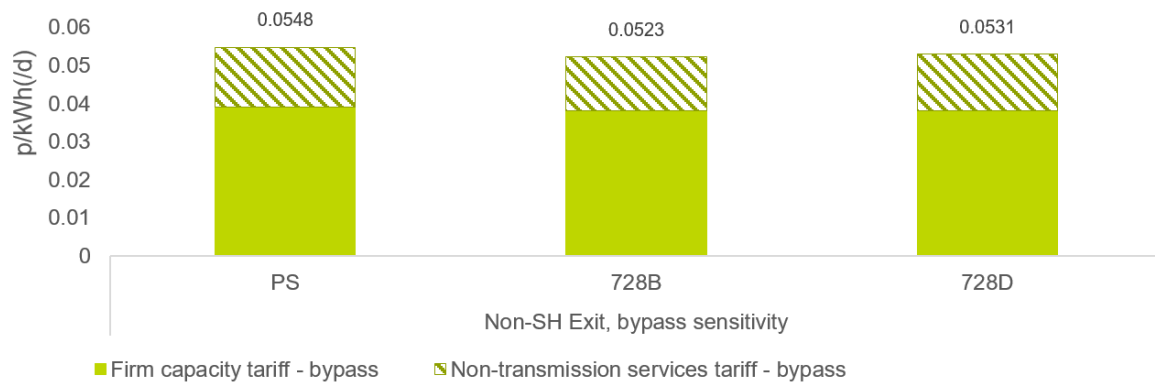
Figure 2 – 'First order' gas consumer welfare (CT, 2022-2031, NPV, discounted to £18/19, source: CEPA Analytical Report)



3.43. Non-eligible short-haul consumers face a direct reduction in welfare from the increase in the exit tariff caused by the proposed discounts. They also face higher wholesale gas prices. On the other hand, eligible users for the short-haul discounts would face a net increase in welfare under all of the options, broadly in proportion to the level of discount observed. However, these users would also face an increase in the wholesale gas price.

3.44. As explained previously, the results presented in Figure 2 are 'first order effects' and assume that all existing users of the gas network remain on the system. However, we note the potential for the first order effects of providing a short-haul discount to be outweighed by the welfare benefit associated with avoiding system bypass. In Figure 3 below, we assess the impacts of bypass on exit tariffs of non-shorthaul users under our 'low bypass sensitivity'. The tariff values incorporate the effect of avoiding bypass based on the assumptions of the 'low bypass sensitivity' highlighted previously.

Figure 3 - Impacts of bypass on tariffs ('low bypass sensitivity') – Exit, non-shorthaul (2030-31, £m 2018/19, source: CEPA Analytical Report)

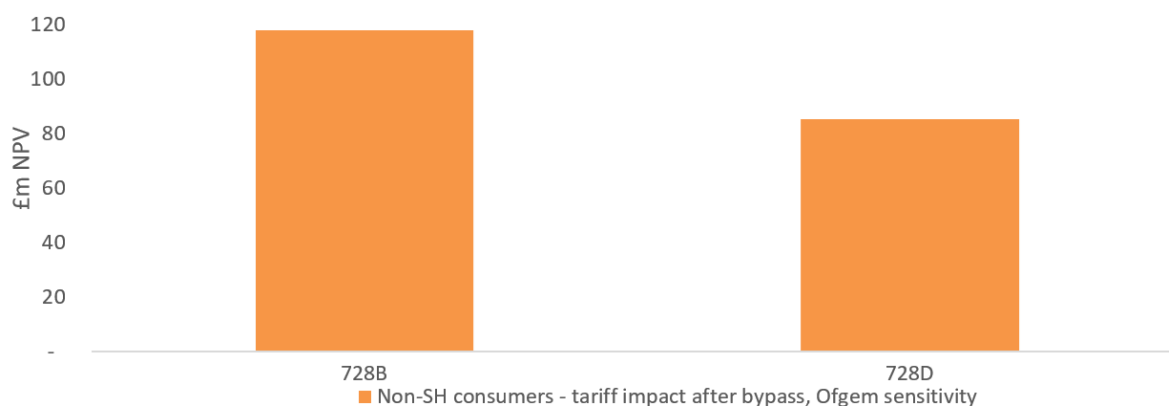


3.45. Figure 3 demonstrates that the exit tariffs for non-eligible short-haul users are lower under both UNC728B and UNC728D compared to the status quo once the risk of bypass is taken into account. Under the low bypass sensitivity, CEPA found that UNC728B results in the lowest exit tariff after considering bypass.²⁸

3.46. We also assess the potential impacts of bypass on consumer welfare, considering only the direct effect on the exit tariff. These results are presented in Figure 4 below:

²⁸ We note that under the high bypass sensitivity, CEPA found that UNC728D resulted in the lowest exit tariff based on modelled estimates of avoided bypass. However, we consider these results to be based on an over-estimate of the risk of bypass.

Figure 4 - Second order effect of bypass on the exit tariff and consumer welfare (low bypass sensitivity), (NPV, 2022-31, £m 2018/19, source: CEPA Analytical Report)



3.47. Due to the impact on the exit tariff, the estimated consumer welfare benefits of avoided bypass under UNC728B are greater than under UNC728D.²⁹

3.48. We note that we have received representations from some stakeholders who have suggested that certain exit points may decide to bypass as a 'cluster', where, for example, a single bypass pipeline can serve two or more exit points. We have asked CEPA to model three potential clusters of exit points.³⁰ We have considered the potential of clustering and CEPA's findings, as part of our holistic assessment of the risk of bypass.

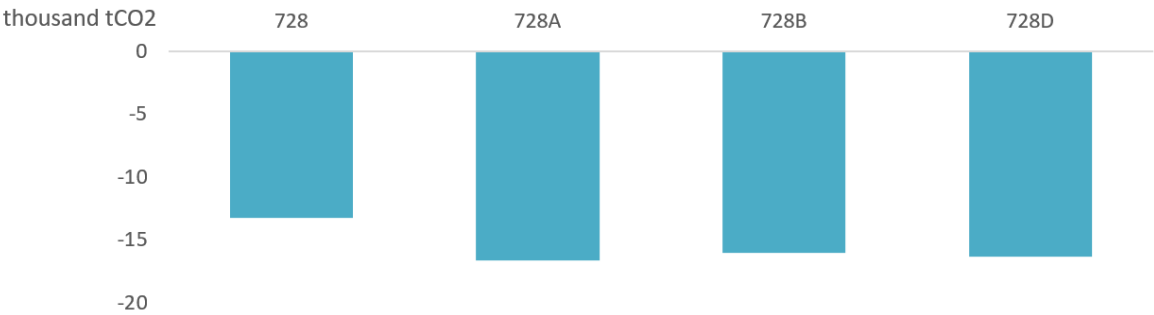
Impacts on carbon emissions

3.49. CEPA has modelled the impacts of the options on carbon emissions. We observe slightly lower emissions under the UNC728 modifications than under the status quo. This is a combination of two factors as a result of the UNC728 options: (i) CEPA observe that in early modelled years, some additional gas-fired power generation replaces high carbon emissions fuels, particularly coal-fired generation; and (ii) CEPA observe a small shift from non-short-haul eligible to short-haul eligible gas-fired power generation. In the aggregate, short-haul eligible gas-fired power generation tend to be larger and more efficient plants relative to the former. This tends to reduce carbon emissions.

²⁹ We note, however, that under the high bypass sensitivity, UNC728D has the highest estimated consumer welfare impact of the change to the exit tariff. However, we consider these results to be based on an over-estimate of the risk of bypass.

³⁰ CEPA Analytical Report, §4.4.

Figure 5 - Changes in average annual carbon dioxide emissions under each option (CT, 2022-31, source: CEPA Analytical Report)



4. Conclusion – Minded to decision

Section summary

In this section, we present our minded to decision and rationale based on the assessment presented in the previous section and the quantitative analysis we have undertaken. We also summarise the next steps, including our expectations surrounding implementation of the final decision.

Questions

Please provide evidence and analysis to support your responses.

Question 6: Do you agree with our minded to decision to approve UNC728B?

We would expect any stakeholders alleging a risk of bypass to provide robust evidence demonstrating that risk, including any confidential commercial information (for instance, specific capital and operational costs required for the construction and operation of a bypass pipeline as well as - where possible - a structural representation of any bypass pipeline(s) they are considering).

Question 7: What are your views on our minded-to decision that implementation of UNC728B should take place from 1 October 2021?

Question 8: Are there any other matters, whether or not addressed in our analysis or minded-to findings, which you think we should take into account in reaching our final determination?

Minded to decision

4.1. We have considered all five UNC728 modification proposals presented to us for decision. Our principles based assessment has been supported by quantitative analysis carried out by CEPA and we have considered each modification proposal against the applicable UNC objectives and our statutory duties. We have also taken into account the full range of information that has been made available to us, including the industry consultation under the UNC728 process, the views of the UNC Panel and the associated workgroup materials. Given the fact that the bypass risk is highly route-specific, we have conducted a comprehensive assessment based on representations provided to us directly by various stakeholders, including some confidential evidence, as well as information that we have sought to assist us in making this decision.

4.2. Our assessment concludes that UNC728B better facilitates the applicable UNC objectives relative to the status quo and approving this modification proposal would be consistent with our principal objective and statutory duties. **Our minded to decision is to approve UNC728B.**

4.3. UNC728D may also better facilitate the applicable UNC objectives compared to the status quo and we consider that the very short distance cap proposed under this modification has advantages. However, the proposed discount under this modification (ie 90% discount on Transmission Services charges and 94% on Non-Transmission Services charges) is too high for the purposes of dis-incentivising bypass. Having said that, when making our final decision, we will take into account any new information submitted to us. We would expect stakeholders in support of UNC728D to provide robust evidence demonstrating that the proposed discount under UNC728B would not suffice to dis-incentivise bypass, with reference to specific capital and operational costs required for the construction and operation of a bypass pipeline as well as (where possible) a structural representation of any bypass pipeline(s) they are considering. We would also expect these stakeholders to show why bypass beyond 5km is not plausible. Similarly, we would expect any other interested party that would not be eligible for a discount under UNC728D, to provide evidence to demonstrate the credibility of any longer bypass pipeline.

4.4. Finally, UNC728/A/C would not better facilitate the applicable UNC objectives and approving any of these modification proposals would not be consistent with our principal objective and statutory duties. This includes the 18km distance cap which has no objective justification. We would expect any parties disagreeing with our assessment to provide specific evidence in support of their views.

4.5. In light of the assessment contained in this document, **our minded-to decision is to approve 'UNC728B - Introduction of Conditional Discount for Avoiding Inefficient Bypass of the NTS with 28km distance cap'.**

Implementation date

4.6. UNC728B states that "implementation will be in line with any Ofgem direction".³¹

4.7. In our 16 July 2020 letter, we said that:

"Articles 29 and 32 of the Tariff Network Code ("TAR NC") together require publication of the "reserve prices" applicable to standard capacity products until at least the end of the gas year, at least thirty days before the annual yearly capacity auction. A key principle of TAR NC is to increase the transparency of transmission tariff structures and procedures towards setting them. Therefore, TAR NC sets out specific requirements for publishing the information related to the derivation of different transmission and non-transmission tariffs (Chapter VIII of TAR NC). [footnote omitted] On 5 June 2020, NGGT published reserve prices ahead of the annual yearly auctions to be held in July. [footnote omitted]"

Each of the modifications proposes using the revenue reconciliation process to introduce a discount to reserve prices in gas year 2020/21. Our view is that to use the revenue reconciliation process in such way for the gas year 2020/21 would be contrary to Articles 29 and 32 TAR NC. These provisions also require that if any of the UNC728/A/B/C/D modifications are to be implemented, a decision to approve one of them will need to be made to allow the 30-day advance publication of the new tariffs before the 2021 annual yearly capacity auction for implementation from October 2021".³²

4.8. During the UNC728 consultation, we asked respondents to consider the question of compliance with the abovementioned provisions of TAR NC and provide views on the proposed implementation date(s).³³ The responses are presented in the FMR.³⁴ We have

³¹ The UNC728/A/B/C/D modifications also state that: "Transmission Services Revenue Recovery Charges, when set or updated, will also take into account the anticipated and actual recovery of revenues from the Conditional Product".

³² Uniform Network Code 728/A/B/C/D (Urgent) - Introduction of a Conditional Discount for Avoiding Inefficient Bypass of the NTS (16 July 2020) <https://www.ofgem.gov.uk/publications-and-updates/uniform-network-code-728abcd-urgent-introduction-conditional-discount-avoiding-inefficient-bypass-nts>

³³ UNC728/A/B/C/D Final Modification Report ("FMR"), page 89 <https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2020-07/Final%20Modification%20Report%200728ABCD%20%28Urgent%29%20v3.0.pdf>

³⁴ See UNC728/A/B/C/D FMR (8 July 2020) pages 89-107.

taken into account these responses and TAR NC requirements when setting out our proposed implementation date.

4.9. 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.

4.10. 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 a short-haul discount for the gas year 2020/21, as proposed, would be contrary to Articles 29 and 32 TAR NC.

4.11. For these reasons, the implementation date for UNC728B will need to allow the 30-day advance publication of the new tariffs reflecting the impact of UNC728B on reserve prices. As the next annual yearly capacity auctions are in July 2021 for capacity from October 2021, we propose that UNC728B should be implemented on **1 October 2021**. This will be dependent on consideration of responses to this consultation.

Appendices

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Appendix 1: Questions on which we are consulting

We want to hear from anyone interested in this consultation. As part of this consultation exercise, we have posed a number of questions below, to assist consultees in providing representations, information and evidence to us in response to our minded to decision. These questions are intended to guide responses, but do not prevent consultees raising other matters which are considered to be material to our final decision.

Please send your response to the email address on this document's front page.

Questions

Please provide evidence and analysis to support your responses.

Question 1: Do you agree with our assessment of the modification options against the applicable UNC objectives? If you disagree, please provide a fully reasoned explanation.

Question 2: What are your views on our conclusion that the proposed modification proposals constitute a 'benchmarking' adjustment to the application of the reference price methodology (Article 6(4) TAR NC)? If you disagree, please provide a fully reasoned explanation.

Question 3: Do you agree with our assessment of the quantitative analysis? If you disagree, please provide a fully reasoned explanation.

Question 4: Do you agree with our assessment that UNC728C is discriminatory because of the risk that the discount may be used for a route other than a qualifying nominated route? If you disagree, please provide a fully reasoned explanation.

Question 5: Do you agree with our assessment of the modification options against our statutory duties? If you disagree, please provide a fully reasoned explanation.

Question 6: Do you agree with our minded to decision to approve UNC728B?

We would expect any stakeholders alleging a risk of bypass to provide robust evidence demonstrating that risk, including any confidential commercial information (for instance, specific capital and operational costs required for the construction and operation of a bypass pipeline as well as - where possible - a structural representation of any bypass pipeline(s) they are considering).

Question 7: What are your views on our minded-to decision that implementation of UNC728B should take place from 1 October 2021?

Question 8: Are there any other matters, whether or not addressed in our analysis or minded-to findings, which you think we should take into account in reaching our final determination?

Appendix 2: Ofgem impact assessment

UNC728/A/B/C/D Introduction of a Conditional Discount for Avoiding Inefficient Bypass of the NTS – Impact Assessment

Division:	Energy Systems Management and Security	Type of measure:	Gas Transmission Charging
Team:	Gas Markets and Systems	Type of IA:	Qualified under Section 5A UA 2000
Associated documents:	CEPA analytical report	Contact for enquiries:	Gas.TransmissionResponse@ofgem.gov.uk

Summary: We have been asked to make a decision on proposals³⁵ to change the UNC relating to the GB gas transmission charging arrangements. The proposals have been through an industry workgroup process and consultation. As a result of the impact that the changes may have, we have decided to publish an Impact Assessment.

What is the problem under consideration? Why is Ofgem intervention necessary?

We have been sent proposals that seek to introduce a discount to the gas transmission charging framework to dis-incentivise inefficient bypass of the NTS by directly connected NTS users located at close proximity to Entry Points. On 1 October 2020, new charging arrangements were implemented resulting from our decision to approve modification UNC678A – ‘Amendments to Gas Transmission Charging Regime (Postage Stamp)’ which was published on 28 May 2020. There are no discounts aimed at dis-incentivising inefficient

³⁵ The proposals consist of the original UNC728 Modification Proposal and four Alternatives (UNC728/A/B/C/D). In this document we refer to them all collectively as “proposals”.

bypass under the current charging methodology which entered into force on 1 October 2020. The proposals were sent to us for decision on 3 July 2020.

What are the policy objectives and intended effects including the effect on Ofgem's Strategic Outcomes

We are required to consider the merits of any proposed changes, and where appropriate, direct that the modification be made. Before making any decision to direct a modification about gas transmission charging, we must satisfy ourselves that:

- the modification better facilitates the relevant UNC objectives as compared with both the status quo and also any alternative modifications put before us, and;
- the modification is consistent with our statutory duties under primary legislation and EU law with specific reference to TAR NC.

What are the policy options that have been considered, including any alternatives to regulation? Please justify the preferred option (further details in Evidence Base)

We have considered UNC728 and the full range of alternative modification proposals put forward to us (five modifications in total). The modifications share a number of features but differ in respect of several characteristics which are set out in the main document.

Preferred option - Monetised Impacts (£m)

Business Impact Target Qualifying Provision	Not yet assessed.
Business Impact Target (EANDCB)	Measure proposed to come into force in October 2021.
Net Benefit to GB Consumer	<p>Central scenario (Consumer Transformation):</p> <p>Option UNC0728B:</p> <p>Central case (2020 FES Consumer Transformation, First order impact³⁶): £-27.3million (CT, NPV, 2022-31, £18/19).</p> <p>Central case (2020 FES Consumer Transformation, second order impact - high/low bypass sensitivity³⁷): £12 million (High bypass sensitivity), £118 million (Low bypass sensitivity) (CT, NPV, 2022-31, £18/19).</p> <p>Sensitivity (Steady Progression):</p> <p>Option UNC0728B:</p> <p>Sensitivity (2020 FES Steady Progression, First order impact): £18.6 million (SP, NPV, 2022-31, £18/19), excluding the potential impact of the option on likelihood of bypass.</p>
<p>Explain how was the Net Benefit monetised</p> <p>Costs and benefits have been modelled for the gas year 2022/23, 2026/27 and 2030/31 (gas years from 1 October). These have been interpolated between the three modelled years for the period 2022-2031. We use 2018/19 prices and we apply the standard social time preference rate (STPR) discount rate of 3.5%.</p> <p>These benefits are limited to the gas market and do not include the effects that changes in tariffs and in the wholesale gas price may have on electricity consumers. CEPA has estimated potential electricity market impacts in its technical report.</p>	

Preferred option - Hard to Monetise Impacts

Describe any hard to monetise impacts, including mid-term strategic and long-term sustainability factors following Ofgem IA guidance

Impacts that bypass may have on the gas wholesale market price or the electricity market price have not been monetised. CEPA estimated the consumer welfare impact of the change to the more direct exit tariff effect.

CEPA's modelling assumes that domestic and I&C gas demand is inflexible (which is appropriate given the small variations in price being considered) and so the impact of an increase in gas demand on carbon emissions in all sectors other than the power sector are not modelled. We would expect the impact to be small, given that there is generally a low price elasticity³⁸, and the small magnitude of the change to the wholesale gas price.

Tariff reform may impact on the revenues of gas producers, gas storage, interconnectors, I&C consumers, and gas-fired power generators. In most cases, we would only expect impacts of the magnitude that we have identified to impact on the investment or closure decisions of these market participants at the margin.

³⁶ First order effects analysis assumes that all existing users of the gas network remain on the system, for details see paragraphs 3.40 - 3.46.

³⁷ Second order effects analysis assesses the potential for a short-haul discount to prevent bypass, ensure revenue recovery from a greater volume of capacity and avoid an associated increase in tariffs for those connected to the NTS. For detail on second order effects and, high and low bypass sensitivity see para 3.40 – 3.46.

³⁸ Gas price elasticities: the impact of gas prices on domestic consumption – a discussion of available evidence, available:
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/532539/Annex_D_Gas_price_elasticities.pdf

Key Assumptions/sensitivities/risks

A number of assumptions have been made within the modelling that are set out in full in CEPA's analytical report.

The benefits for consumers are likely to be sensitive to supply and demand fundamentals which are observed in practice. Given that different options may have quite different impacts depending on the effect that they have on the marginal unit of gas or electricity supply, where the marginal unit differs from that modelled, the consumer welfare impacts may change from those estimated.

The changes in the electricity wholesale price may impact on the revenues of electricity generators. If they seek to recover any lost revenues from the capacity market, some of the benefits may be counterbalanced by higher capacity market costs. Given the small impact of the options on the electricity price, CEPA expect any impacts on the capacity market to be limited.

Will the policy be reviewed? Yes	If applicable, set review date: As required by TAR NC and ad-hoc in response to changes in the gas market
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Is this proposal in scope of the Public Sector Equality Duty?	Yes
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Appendix 3 – Privacy notice on consultations

Personal data

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller, (for ease of reference, “Ofgem”). The Data Protection Officer can be contacted at dpo@ofgem.gov.uk

2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest, ie a consultation.

4. With whom we will be sharing your personal data

We will not share your personal data with other organisations. We will publish non-confidential consultation responses, redacting any personal data that may be contained within them.

5. For how long we will keep your personal data, or criteria used to determine the retention period.

Your personal data will be held for one year after the project is closed.

6. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data
- access your personal data

- have personal data corrected if it is inaccurate or incomplete
- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data
- object to certain ways we use your data
- tell us if we can share your information with 3rd parties
- tell us your preferred frequency, content and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at <https://ico.org.uk/> , or telephone 0303 123 1113.

7. Your personal data will not be sent overseas.

8. Your personal data will not be used for any automated decision making.

9. Your personal data will be stored in a secure government IT system.

10. More information For more information on how Ofgem processes your data, click on the link to our "[Ofgem privacy promise](#)".