Modification proposal:	**Uniform Network Code (UNC) 0730V: COVID-19 Capacity Retention Process**		
Decision:	The Authority[1] has decided to reject this modification[2]		
Target audience:	UNC Panel, Parties to the UNC and other interested parties		
Date of publication:	19 March 2021	Implementation date:	n/a

Background

COVID-19 presents challenges for the energy industry to tackle on behalf of the homes and businesses that depend on the sector for gas and electricity. The lockdown of non-essential sectors of the economy, the re-purposing of some sites and changes in consumer behaviour means that energy consumption is varying from normal seasonal patterns to an unprecedented extent. This has a consequential impact throughout the energy supply chain.

The Proposer explains that many businesses, consumers as well as Gas Shippers and Suppliers are being adversely impacted and are incurring detriment due to measures implemented by the UK Government as a direct result of the COVID-19 pandemic.

The modification proposal

UNC730V was raised by Gazprom (the Proposer) and seeks to apply a discount of 50% to Local Distribution Zone (LDZ) Capacity Costs for sites that are set as Isolated (utilising the process introduced by UNC Modification 0723).[3] The remaining 50% payment would be seen as a Capacity retention payment guaranteeing the continued availability of full capacity at that site.

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[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] 0723 (Urgent) - Use of the Isolation Flag to identify sites with abnormal load reduction during COVID-19 period https://www.ofgem.gov.uk/publications-and-updates/authority-decision-unc722-unc723-unc724-and-consent-modify-c058

By linking the proposal to UNC723 the Proposer feels that this will address concerns over a suitable verification process by using the arrangements previously approved for UNC723.

UNC730V focuses on providing relief for non-domestic customers by way of a reduction of transportation charges levied on the Shipper. This is where they, for reasons outside their control, have had to cease operations or trading as a direct result of the pandemic related lockdowns. It is explained that whilst these sites are either closed or utilising minimal levels of gas, the current charging arrangements do not cater for any specific relief from capacity charges with the customers still being liable for these charges.

The Proposer further notes that it is important that business consumers are charged fairly for their actual gas network use, otherwise businesses may exit the UK market permanently, leading to a potential adverse impact on all remaining consumers' costs in the future.
The Proposer's view is that it is fair and proportionate to utilise the isolated status of a supply point to enable Shippers to offer partial (50%) relief from capacity charges, without requiring a full Supply Point Withdrawal.

UNC Panel[4] recommendation

At the UNC Panel meeting on 21 January 2021 a majority of the UNC Panel considered that UNC730V would not better facilitate the identified UNC objectives and the Panel therefore did not recommend its approval.

Our decision

We have considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 22 January 2021. We have considered and taken into account the responses to the industry consultations on the modification proposal which are attached to the FMR[5]. We have concluded that:

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[4] The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.
[5] UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.co.uk

- implementation of the modification proposal will not better facilitate the achievement of the identified relevant or charging methodology objectives of the UNC.[6]

Reasons for our decision

In coming to our decision we have considered whether the proposed code modification contributes to better facilitating the identified code objectives. We have been mindful of the unprecedented challenges posed by COVID-19 related national lockdowns; as well as the fact that gas demand has in some cases been restricted by the necessity to comply with statutory requirements aimed at mitigating the spread of the virus, rather than at the discretion of the consumer.

We have sought to balance the recognition of these circumstances against the principles which underpin the UNC charging arrangements, the industry's financial circumstances during the pandemic and our statutory duties and responsibilities. We have also had regard to the potential issues which have been highlighted within the individual representations received to the consultations issued for this modification.

We agree with respondents and the UNC Panel who considered that this proposal should be assessed against UNC relevant objectives (a) and (d) and charging methodology objective (c). We also agree with the consideration that this modification has a neutral impact on the other relevant and charging methodology objectives.

We consider this modification proposal will not better facilitate the identified UNC relevant or charging methodology objectives.

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

The solution proposed under UNC730V would apply a discount of 50% to LDZ Capacity Costs for sites that are set as Isolated (utilising the process in UNC723). The remaining 50% charge would be categorised as a Capacity retention payment guaranteeing the continued availability

[6] As set out in Standard Special Condition A11(1) of the Gas Transporters Licence: http://epr.ofgem.gov.uk/Pages/EPRInformation.aspx?doc=http%3a%2f%2fepr.ofgem.gov.uk%2fEPRFiles%2fStandard+Special+Condition+PART_A__-_Consolidated_-_Current+Version.pdf

of the full capacity at these sites. The rationale for why this solution would better facilitate this objective is that short term relief in Capacity charges to Shippers could be passed on to suppliers and ultimately end consumers. The Proposer's view is that this could help avoid some non-domestic sites permanently disconnecting from the network. It's argued that this would not be in the interests of the efficient and economic operation of the network and may lead to underutilisation in the longer term. Therefore, as the loss of this capacity could result in higher costs for remaining customers, any initiative that seeks to help mitigate this long term loss with a short term capacity charge reduction should be considered to deliver an overall benefit to all consumers.

We acknowledge the Proposer's argument and the correlations being drawn regarding non-domestic sites ceasing to use the network and the effects of that scenario. It is noted that, if these consumers are not replaced entirely or within the same area, the existing capacity may become underutilised, which may then require costs to be recovered from all other users of the network. However, there has been no direct evidence or analysis presented within the FMR to substantiate these assertions. Accordingly, we are unable to quantify this risk of disconnection, the likelihood that the network will become or remain underutilised, or the extent to which the short-term relief from 50% of the Capacity charges which UNC730V may offer would mitigate that risk. We also note that many companies will currently be benefitting from Government support programmes which will, at least to some extent, offset the impacts of COVID-19 lockdowns upon their businesses. We are unaware whether these factors were taken into account due to not having been provided complete analysis in relation to these areas within the FMR. Therefore, we are unable to quantify the risks of disconnection or validate these arguments.

Respondents also raised the issue that the cost of maintaining the network would remain the same whilst the revenue from capacity charges would decrease. This would mean that any shortfall would likely need to be socialised to the other parts of the Shipper community. The impact of this modification is not fully explained within the FMR as there are no estimates of how many sites would qualify for this relief, the magnitude of the rebate or how this would be socialised among other Shippers and the effects of that on their financial positions as well as ultimately the effects on consumers.

Respondents also highlighted that the modification proposes allowing these sites to keep 100% of their capacity whilst receiving a 50% rebate on the Capacity charge. It was noted that this could be viewed as a potential inefficient use of the network, as other system users would not be able to utilise the spare capacity during the time in which the reduction in charges would be applicable. In our view, this would in effect keep the network in stasis, at a time when demand is unpredictable, which would not lead to a more efficient and economic use of the system.

We had asked for analysis of which sites would qualify for this relief, and a quantification of the financial impacts of this reduction in capacity charges, alongside the other items of evidence mentioned within this letter during the development of this modification. However, this is not contained within the FMR for our consideration of this modification.

We have reviewed the arguments given for approval, the issues raised, the analysis that has been provided; we have assessed this information against this Objective based upon the information that has been provided in the FMR. We are of the view that UNC730V would not have a positive impact against this Objective, it would likely be neutral with a potential to have a slightly negative effect due to the identified contributing issues.

Relative Objective d) 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.

And

Relevant Charging Methodology 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

The two objectives cited within the FMR relating to competition – Relative Objective (d) and Charging Methodology Objective (c) - will be dealt with together for the purposes of this decision. The Proposer's position is that this modification would improve cost reflectivity of capacity charges by better aligning them with a customer's actual system usage, thereby furthering competition between Shippers and Suppliers.

The premise upon which this modification has been raised is that due to the current COVID-19 pandemic lockdown provisions, certain non-domestic sites are not operating or doing so on a very limited basis and therefore require relief to alleviate financial pressure. It is not explained within the FMR how competition would be better facilitated if these sites are not operating or doing so in a limited capacity. Our view is that this type of financial relief would not enable competition between parties but potentially facilitate some companies to remain viable and not disconnect permanently from the network. We view competition across the market, not that an individual user would potentially remain competitive in the market. In addition, there has been no meaningful analysis or assessment provided of how this modification would affect these companies' financial positions, or whether a reduction in these charges would be a factor in determining the outcome of their operation(s). Further to this, there has been no consideration of how existing government schemes of financial support packages are assisting these customers.

There were also issues raised during the course of the consultations and Panel discussions concerning the effects of reducing these costs whilst allowing retention of full capacity. It was accepted that the proposed 50% reduction in Capacity charges would likely need to be socialised to the generality of Shippers, creating a cross subsidy. We are also aware that another concern raised was that there is no mechanism proposed to ensure that any reduction of the Capacity charges is passed in full to the relevant supplier and ultimately to the end consumer.

The FMR does not contain any meaningful explanation or mitigations of how these issues would be addressed. We also would have expected a robust level of evidence and analysis to be included to fully examine these concerns, including how any socialisation of costs would impact other Shippers; however, the FMR does not provide this and these remain issues of concern. For these reasons, we consider these two objectives to not be impacted by this modification and could potentially have a detrimental effect due to the creation of a cross subsidy amongst Shippers.

Other Issues

We are conscious of the challenges being faced by the energy industry due to the COVID-19 pandemic and are sympathetic to the spirit of this modification to provide relief to this sector of the market. However, we need to ensure that all modifications which we receive are robust and contain sufficient levels of analysis to underpin the solution which ultimately informs our decision. Whilst the premise of UNC730V seeks to provide a sector of the market with relief for their consumers, the effects of implementing this modification have not been fully considered within the FMR. The lack of robust, complete evidence and consideration of the identified issues, including the impacts on other Shippers which could potentially redistribute potential financial distress to other parts of the industry or their customers, has led to our decision to reject this modification.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority has decided that modification proposal *UNC 0730V 'COVID-19 Capacity Retention* Process' should not be made.

Jacqui Russell
Head of Metering & Market Operations
Signed on behalf of the Authority and authorised for that purpose