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| Modification proposal: | <b>Uniform Network Code (UNC) 560: Addressing under-allocation of flows from BBL arising from misalignment of reference conditions</b> |                      |                        |
| Decision:              | The Authority <sup>1</sup> directs this modification be made <sup>2</sup>  |                      |                        |
| Target audience:       | UNC Panel, Parties to the UNC and other interested parties   |                      |                        |
| Date of publication:   | 4 December 2015  | Implementation date: | As soon as practicable |

## Background

The final report of the European Commission's sector inquiry into competition in gas and electricity markets (published in January 2007) noted (amongst other things) the lack of effective competition in European markets.<sup>3</sup>

In response, a suite of legally binding European Union (EU) legislation, referred to as the Third Package, on European electricity and gas markets was introduced and adopted on 13 July 2009.<sup>4</sup> The Third Package was transposed into law in Great Britain (GB) by regulations that came into force on 10 November 2011.

The Third Package created a new legal framework to promote cross-border trade. It requires a number of legally binding Guidelines and European Network Codes (ENCs) to be established and implemented.<sup>5</sup> Taken together, these aim to promote liquidity, improve integration between Member States' gas markets and promote the efficient use of interconnectors to ensure that gas flows according to price signals, ie to where it is valued most.<sup>6</sup> These EU legislative requirements take priority over GB domestic legislation and associated regulations and codes, including the Uniform Network Code (UNC).

The ENCs related to this modification are Gas Balancing of Transmission Networks (BAL) and Interoperability and Data Exchange (INT). BAL was published on 27 March 2014 and applies from 1 October 2015.<sup>7</sup> BAL aims to facilitate cross-border gas trade and the further development of competitive and efficient wholesale gas markets in the EU. The ENC requires the use of non-discriminatory and transparent balancing systems, which are of particular importance for new market entrants. INT was published on 1 May 2015 and applies from 1 May 2016.<sup>8</sup> The INT code covers ways in which network operators manage

<sup>1</sup> 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.

<sup>2</sup> This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

<sup>3</sup> Inquiry pursuant to Article 17 of Regulation (EC) No 1/2003 into the European gas and electricity sectors (Final Report): [http://ec.europa.eu/competition/sectors/energy/2005\\_inquiry/index\\_en.html](http://ec.europa.eu/competition/sectors/energy/2005_inquiry/index_en.html).

<sup>4</sup> In relation to gas, the Third Package includes Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC (the "Gas Directive") 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 and repealing Regulation (EC) No 1775/2005 (the "Gas Regulation").

<sup>5</sup> See Article 6 (Establishment of network codes) of the Gas Regulation which sets out the process for establishing EU-wide network codes for gas.

<sup>6</sup> See Article 8(6) of the Gas Regulation for the areas required to be covered by network codes.

<sup>7</sup> Commission Regulation (EU) No 312/2014 of 26 March 2014 establishing a Network Code on Gas Balancing of Transmission Networks: [http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2014.091.01.0015.01.ENG](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.091.01.0015.01.ENG).

<sup>8</sup> Commission regulation (EU) 2015/703 of 30 April 2015 establishing a network code on interoperability and data exchange rules [http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1430734293842&uri=OJ:JOL\\_2015\\_113\\_R\\_0003](http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1430734293842&uri=OJ:JOL_2015_113_R_0003).

gas flows across borders, deal with differences in gas quality and exchange data between themselves and market players.

The measurement of a quantity of gas is sensitive to several factors and one aspect of the INT ENC is to provide harmonisation of the reference conditions for the calculation of volume and calorific value at Interconnection Points (IPs). One of these conditions is temperature. In order to get consistency, measurements are corrected using constant reference temperatures. This provides a consistent approach to calculating volume and calorific value (which is in turn used to derive a measure of energy). Although these reference conditions fundamentally relate to physical measurement, commercial energy figures such as capacity bookings, nominations and allocations can also be quoted using a particular reference condition. This is recognised by the UNC General Terms Section C 'Interpretation'. The GB regime currently uses reference conditions of 15°C for both volume and calorific value (hereafter referred to as '15/15'). These reference conditions currently vary across Europe. INT requires the use of reference conditions of 0°C for volume and 25°C for calorific value (hereafter referred to as '0/25') for data exchange and publication at IPs.

UNC519 was raised by National Grid Gas (NGG)(NTS) on 7 November 2014. It seeks to implement the 0/25 reference conditions at GB IPs.<sup>9</sup> It will do this by making changes to the European Interconnection Document (EID), which forms part of the UNC, to obligate the use of 0/25 reference conditions at IPs only. UNC519 was approved by the Authority and is due to be implemented on 1 May 2016.

BAL and INT mandate shipper nominations at IPs to be submitted, matched and allocated at 0/25 reference conditions from 1 May 2016. The GB regime will therefore change to meet this requirement on 1 May 2016 as a result of UNC519. However, the BBL interconnector has always operated to these reference conditions and continues to do so following the introduction of the new matching and allocation arrangements (introduced by BAL and INT) on 1 October 2015. As a result, allocations for BBL Users will be under-allocated during the period from 1 October 2015 to 1 May 2016.<sup>10</sup> This will expose parties shipping gas through the BBL IP (BBL Users) to an imbalance position until such time as NGG(NTS) implements the systems solution for UNC519.

### **The modification proposal**

UNC560 was raised by GasTerra on 30 September 2015.<sup>11</sup> UNC560 proposes that there should be a correction for BBL Users to reflect the costs incurred as a result of the under-allocation. This would be accomplished by a monthly correction to the BBL Users' daily imbalance charges, carried out at the time of invoicing for energy balancing charges.

It is proposed that NGG(NTS) should, when producing energy balancing invoices each month, calculate what the allocations for all BBL Users that have an allocation of gas in respect of BBL IP would have been at 15/15 (using the same conversion factor as specified in UNC519) and make adjustments/corrections to BBL Users' imbalance charges and to energy balancing neutrality as required.

The Proposer requested that the modification follow an urgent timetable. At a meeting on 15 October 2015, the Panel voted unanimously to recommend that UNC560 should follow

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<sup>9</sup> UNC519 Harmonisation of Reference Conditions at Interconnection Points  
(<http://www.gasgovernance.co.uk/0519>)

<sup>10</sup> This is explained further below in the reasons for our decision.

<sup>11</sup> UNC560 Addressing under-allocation of flows from BBL arising from misalignment of reference conditions  
(<http://www.gasgovernance.co.uk/0560>)

urgent procedures. On 21 October 2015, we issued our decision to agree to urgent treatment of UNC560, and the timetable to be followed.<sup>12</sup>

### **UNC Panel<sup>13</sup> recommendation**

At the UNC Panel meeting on 19 November 2015, the UNC Panel unanimously considered that UNC560 would better facilitate the achievement of the UNC objectives and the Panel therefore recommended its approval. Members considered the relevant objectives, agreeing that implementation would further relevant objective d) '*Securing of effective competition*' by addressing an issue that would otherwise competitively disadvantage a certain group of users through no fault of their own. Members also agreed that implementation would further relevant objective g) '*Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators*' on the grounds that the modification supports compliance with a key objective of BAL.

### **Our decision**

We have considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 19 November 2015. We have considered and taken into account the responses to the industry consultation on the modification proposal which are attached to the FMR.<sup>14</sup> We have concluded that:

- implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC;<sup>15</sup> and
- directing that the modification be made is consistent with our principal objective and statutory duties.<sup>16</sup>

### **Reasons for our decision**

We consider this modification proposal will better facilitate UNC objectives (d) and (g) and has a neutral impact on the other relevant objectives.

***(d) so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition:***

***(i) between relevant shippers;***

Under the new nomination and allocation rules at IPs prescribed by the ENCs, shipper nominations to each transmission system operator (TSO) at an IP will be matched before they are allocated gas equal to their confirmed nomination quantity.<sup>17</sup> As the measurement of gas is dependent on temperature, and NGG(NTS) and BBL will use different reference conditions between 1 October 2015 and 1 May 2016, the nominated

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<sup>12</sup><http://www.gasgovernance.co.uk/sites/default/files/UNC%200560%20request%20for%20urgency%20decision.pdf>

<sup>13</sup> The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

<sup>14</sup> UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at [www.gasgovernance.co.uk](http://www.gasgovernance.co.uk)

<sup>15</sup> As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, available at: <https://epr.ofgem.gov.uk/Content/Documents/Standard%20Special%20Condition%20-%20PART%20A%20Consolidated%20-%20Current%20Version.pdf>

<sup>16</sup> 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.

<sup>17</sup> INT does consider instances where nominations will not equal allocations ('Non OBA Days'). These are expected to be rare and not discussed in UNC560 so we have not considered them in this decision.

quantities on either side of the IP will differ. The nomination matching rules for NGG(NTS) and BBL state that the BBL nominated quantity shall prevail and this is what will be allocated to shippers. This will result in an under-allocation to BBL Users compared to what was originally intended to flow across the IP. In order to avoid imbalance charges, BBL Users will then have to purchase more gas in order to ship what they originally intended to. This is as a result of something outside of their control and places them at a disadvantage to those shippers who do not need to acquire additional gas. We therefore consider that UNC560 better facilitates relevant objective (d)(i).

***(g) compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators***

BAL seeks to give network users the certainty that they can manage their positions in different balancing zones in an economically efficient and non-discriminatory manner. If different reference conditions are used on either side of an IP, affected users may need to take further action than would be the case for other IPs across Europe. This is not efficient and may discriminate between users active at different IPs. We therefore consider that UNC560 better facilitates compliance with the Regulation by ensuring the objectives of BAL are achieved.

Retrospectivity

UNC560 proposes that the adjustments made by NGG(NTS) should be made from 1 October 2015. Given the date on which this modification proposal was submitted to Ofgem for decision, the modification contains an element which has retrospective effect, in the sense that the correction calculations look back to dates falling before the potential implementation of this modification.

We have previously published guidance on code modification urgency criteria which also considers retrospective adjustments.<sup>18</sup> Our view remains that retrospective modifications should generally be avoided as they undermine market confidence. It is a general principle that rules ought not to change the character of past transactions, completed on the basis of the then existing rules. However, despite the general principle against retrospective rule changes, we believe that there may occasionally be exceptions that could give rise to the need for a modification which would have retrospective effect.

The proposer of UNC560 considers that a retrospective adjustment is justified in this case because:

- the proposal is a temporary workaround until UNC519 is implemented and follows the same principles;
- the modification is being made as a result of a situation where the fault/error giving rise to additional costs/losses is directly attributable to central arrangements;
- the issue was not foreseen and only brought to parties' attention during a period of intensive preparation for ENC implementation; and
- the potential for retrospective action was clearly flagged in advance.

Regarding the first point above, our view is that a solution, being temporary in nature, is not, by itself, more or less justification for retrospectivity. However we do note that by

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<sup>18</sup> <https://www.ofgem.gov.uk/publications-and-updates/ofgem-guidance-code-modification-urgency-criteria>

following the same principles of UNC519, and with no further adjustments, UNC560 could be considered as analogous to early implementation of UNC519 for BBL Users. The temporary nature of the proposal may also provide comfort to other users as it only affects those who chose to be active on a given day.

Regarding the second point above, the proposer's view is that this situation is the result of: (i) a lack of alignment between BBL and NGG (NTS)'s implementation timescales for solutions to the change in reference conditions; and (ii) different implementation dates of INT and BAL. While the lack of aligned implementation timescales are not ideal, we do not think, however, that it is necessarily a fault or error in the central arrangements that can only be resolved by a retrospective adjustment. For instance, we note that a similar modification has not been raised in relation to the IP between NGG(NTS) and Interconnector UK.

Regarding the third point above, the proposer argues that the issue was not foreseen and only brought to shippers' attention at a time of intense regulatory change. We understand that the issue of misalignment between BBL and NGG(NTS) was first raised in NGG (NTS)'s response to UNC519 on 24 April 2015. NGG(NTS) also raised the issue at UNC working groups over the summer. This may have been sufficient time for a modification to have been raised and implemented from 1 October 2015 which would have avoided the need for retrospective changes. We do note however that the unintended consequences of implementing BAL and INT on different dates was not foreseen during the development of the ENCs and subsequent modifications. Finally, we do not consider that retrospective adjustments should be allowed simply because there is an otherwise high volume of change at a particular time.

Regarding the fourth point above, we think the argument that the potential for retrospective adjustments has been clearly flagged in advance has merit. The modification was raised on 30 September 2015 with adjustments on gas days from 1 October 2015 onwards. It is by virtue of the time needed to complete the modification process, even on urgent timescales, that means that there will be a retrospective adjustment. All parties were made aware of this and given the opportunity to respond. We also note the majority of respondents to the consultation felt that retrospective action may be justified in this case. Furthermore, we note that only the first adjustment will be retrospective. All others will be at the time the original invoice is due to be produced by NGG(NTS).

On balance, we have considered the potential for a retrospective implementation of UNC560 and have decided that it is appropriate in this case. The changes proposed are 'ring fenced' to a subset of users, are for a limited period of time, and have been clearly flagged to all parties in advance of implementation.

One respondent commented that it would not expect the Authority to reject UNC560 on the grounds of retrospectivity having previously approved it as part of UNC534 *'Maintaining the efficacy of the NTS Optional Commodity ('shorthaul') tariff at Bacton entry points'*. In line with our guidance, we have reached our decision by assessing the retrospective element of UNC560 on its own merits. Our decision does not therefore fetter the Authority's discretion on whether to reject or to approve future modifications which contain a retrospective element. The decisions will be based on the merits of each particular case and on whether we consider retrospective implementation to be appropriate. We will assess each proposal on a case-by-case basis.

## **Decision notice**

In accordance with Standard Special Condition A11 of the Gas Transporters licence, the Authority hereby directs that modification proposal UNC560: '*Addressing under-allocation of flows from BBL arising from misalignment of reference conditions*' be made.

**Rob Mills**

**Head of Gas Transmission, Gas Networks**

Signed on behalf of the Authority and authorised for that purpose