

## Representation - Draft Modification Report UNC 0686

### Removal of the NTS Optional Commodity Rate with adequate notice

**Responses invited by: 5pm on 07 June 2019**

To: [enquiries@gasgovernance.co.uk](mailto:enquiries@gasgovernance.co.uk)

<b>Representative:</b>	Kirsty Ingham / Kamila Nugumanova
<b>Organisation:</b>	ESB
<b>Date of Representation:</b>	7 June 2019
<b>Support or oppose implementation?</b>	Oppose
<b>Relevant Objective:</b>	<p><b>c)</b> Negative</p> <p><b>d)</b> Negative</p> <p><b>g)</b> None</p>
<b>Relevant Charging Methodology Objective:</b>	<p><b>a)</b> Negative</p> <p><b>b)</b> Negative</p> <p><b>c)</b> Negative</p> <p><b>e)</b> None</p>

Standard Relevant Objectives:

- c) In our view the impact is fundamentally negative under objective c), as it can only be inefficient discharge of the licensee's obligations for changes from UNC 686 to take place when holistic charging reform is proposed and in progress under UNC 678. Furthermore, we do not consider that compliance with EU legislation is furthered by UNC 686 (full explanation provided below).
- d) Making multiple, uncoordinated changes to the charging regime can only be negative for competition and end consumers due to uncertainty and inefficiency.
- g) We do not consider that compliance with EU legislation is furthered by UNC 686.

Relevant Charging Methodology Objectives:

- a) The proposer states that UNC 686 will improve cost reflectivity, when in fact it removes an element which attempted to reflect cost reflectivity. The redistribution of commodity charge recovery will not serve to improve cost reflectivity for any Shipper or end-user as it is socialised across all as a flat rate.

- b) UNC 686 has been raised concurrently with UNC 678 and alternatives. As discussed above, raising a proposal which addresses only a single part of an holistic reform is counter-productive and clearly does not take into account developments in the transport business.
- c) Making multiple, uncoordinated changes to the charging regime can only be negative for competition and end consumers due to uncertainty and inefficiency.
- g) We do not consider that compliance with EU legislation is furthered by UNC 686.

**Reason for support/opposition: Please summarise (in one paragraph) the key reason(s)**

**Does not facilitate better compliance with TAR NC**

The main rationale put forward by the proposal is the possibility to have a more compliant methodology by 31 May 2019 by “being compliant in respect of the OCR which has already been recognised as non-compliant”. We do not believe the proposal facilitates compliance with the relevant EU regulation since it only addresses one aspect of compliance whereas the subject matter of the TAR NC is “harmonised transmission tariff structures for gas” as identified in Article 8(6) of the Gas Regulation. The choice of RPM is a central topic of the TAR NC and it entails compliance with a number of principles and rules in addition to the OCC charge treatment. Therefore, we agree with Ofgem’s view provided in its decision not to grant Urgency to this Modification that: “UNC686, by removing the OCC, would not ensure that the prevailing NTS Charging Methodology is compliant with TAR NC”.<sup>1</sup>

It is even in doubt that the principle of an optional charge is problematic from a compliance perspective: Ofgem’s 0621 decision letter<sup>2</sup> was clear that the *commodity element* in the approach was the identified compliance issue within the context of a full and enduring change to the methodology. Ofgem indicated that if it could be demonstrated that avoidance of inefficient bypass was justified then a suitable product would not be ruled out.

**Does not address the issue of cross-subsidy and discrimination**

Furthermore, the proposal implies that current availability of the OCR charge appears to be unduly discriminatory and anti-competitive, and therefore would be in breach of EU regulation 2009/715 which prescribes that “tariffs, or the methodologies used to calculate them, shall be applied in a non-discriminatory manner”. This concept has previously

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<sup>1</sup><https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/book/2019-04/UNC0686%20-%20Urgency%20decision.pdf>

<sup>2</sup><https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/page/2018-12/Ofgem%20Decision%20Letter%200621.pdf>

been raised and put forward by UNC 636. In the decision letter on UNC 636,<sup>3</sup> Ofgem has noted the following:

*“Finally, we note that the ‘cross subsidy’ that UNC 636 aims to remedy, may arise in part from the increase in the Standard Commodity Charges; not from the OCC itself. As such, we consider there are benefits to reviewing the OCC as part of the wider-scale reform currently being considered.”*

This strengthens the point that compliance with TAR NC would require a much more holistic and enduring solution rather than reviewing this separate aspect of the charging methodology.

Moreover, Ofgem has been clear on its approach to reviewing the gas transmission tariff structure and has noted in the decision letter on UNC 636 that OCC should not be looked at in isolation, but should be treated as part of the comprehensive solution instead:

*“Given the wider scale reform currently under consideration, we think that the OCC should not be looked at in isolation, but should be considered holistically in the context of the wider charging landscape [...] This would allow the simultaneous examination of the OCC with the Standard Commodity Charges.”*

### **Additional uncertainty and complexity**

An incomplete solution and a short-notice change to OCR and commodity tariffs would lead to increased uncertainty for the industry and consumers. Implementation of this proposal would have a significant material impact on existing commercial contracts and would lead to higher costs for shippers and I&C consumers, resulting from a need to review and re-open trading and hedge positions, as well as associated commercial and legal costs.

In addition, the proposal aims to act as a transitional solution until a more permanent charging model is implemented as part of UNC 678 or its alternatives. The proposal acknowledges that “Modification 0678 would affect other tariffs including the possibility of a new “efficient by-pass” charge if desirable.” It is our view that such a transitional arrangement would create uncertainty and instability in the market and would result in an increased operational and financial cost to the industry. In the UNC 636 decision letter, Ofgem already acknowledged this possible disruption and explicitly noted that it may outweigh the potential benefits:

*“We consider that such disruption may outweigh any potential benefits, given that the proposed modifications are likely to be implemented for one year or less given wider industry reform to implement EU Regulation 2017/460 (TAR NC).”*

Additionally, the proposer cites provision of “a transition step to a more compliant solution” as a positive; the transition period in UNC 621 was seen by Ofgem in its decision letter as a negative aspect. Uncertainty and repeated changes in regime result in inclusion of risk premia in prices; short-term change will lead to unnecessary instability and step changes in end-user gas and power prices.

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<sup>3</sup> [https://www.ofgem.gov.uk/system/files/docs/2018/07/unc0636\\_d.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/07/unc0636_d.pdf)

## Interaction with other mods

UNC 686 places an increased reliance on UNC 678 or any of its alternatives for the introduction of an enduring product. While the proposal states that it does not aim to replace UNC 678, but instead to compliment it, UNC 678 itself is a modification in progress and is subject to authority decision. We do not believe it is prudent to include a reference to a modification that may or may not be progressed.

Furthermore, eventual removal of the OCC in any form would be a potential conclusion of UNC 670R if it found that OCC were not compliant and could not be justified. Note UNC 670R progress was suspended during UNC 678 development to prevent overlaps, distraction and avoid uncertainty of baseline; the aim was for full and detailed analysis to be carried out to resolve the issue of inefficient bypass in the GB context.

## Ofgem's statutory duties

Ofgem has noted in the decision letter on UNC 636 that a consideration has to be given to the wider statutory duties of the Regulator when assessing a change. We are concerned that implementing a disjointed and incomplete solution such as UNC 686 will not be in line with regulatory best practice and could be considered as disproportionate and inconsistent. We fully agree with Ofgem's view expressed in the UNC 636 decision letter that: *"a piecemeal approach at this time could create unnecessary uncertainty and undermine long-term planning and effective competition", which would not be compatible with Ofgem's statutory duties and regulatory principles."*

In our view the following regulatory considerations should be taken into account:

- It would be prudent for review and development of an enduring solution for inefficient bypass to be conducted contiguously with 0678, as was prescribed in GCD11.
- This would avoid swings and uncertainty in charging from a short-term change, mindful of the objectives of 0678 for predictability and stability of charging.
- This would also allow for the solution to be reviewed in full by ACER, neighbouring NRAs and other interested parties via consultation, as was outlined in 0636C and 0636D.

In this context in particular, rejection or suspension of UNC 686 appears the best solution to prevent further inefficiency and uncertainty in addition to that caused by UNC 678, while supporting the facilitation of the best outcome for UNC 678/UNC 670R.

### **Implementation:** *What lead-time do you wish to see prior to implementation and why?*

We do not support implementation of this modification. If the proposal is approved in accordance with its requested and recommended timelines, it would have a detrimental effect on the commercial arrangements of many NTS users as well as an increase in charges for many end consumers. The implementation date would not provide adequate

time for users to address this major change and adjust their systems to the new regime. The Proposer has included analysis of benefits that would be passed through to end-users. Given timelines for contracting and the lag in pass-through to small end-users in particular, the likelihood of these benefits being realised by consumers is minimal.

**Impacts and Costs:** *What analysis, development and ongoing costs would you face?*

As with UNC 636 before, the impact of this proposed change is wide ranging: whole system economics need to be considered. This includes electricity markets as well as gas, as National Grid's analysis for UNC 636 clearly indicates that power station exit points are OCC users. Also the effects on the entire United Kingdom should be reviewed.

In addition, the actual impacts and costs of the proposal are not clear and there is no detailed analysis to underpin the decision. The envisaged benefits are based on high-level assumptions and projections. We do not think there is sufficient analysis for Ofgem to make a decision on the impacts of this mod on charging relevant objectives as well as overall impacts on competition and long-term planning.

As with UNC 636, the stated impact disregards the potential impact on gas flows and changes in booking behaviours resulting from the changes in commodity charges for OCC users.

The lack of analysis does not reflect the impact on existing commercial contracts that are already likely to be in place for GY 2019. Ofgem issued a call for evidence for UNC 636, in order to gather confidential information from OCC users to gain understanding of potential impacts. We recommend Ofgem refers to this and/or consider a similar exercise for this Modification.

**Legal Text:** *Are you satisfied that the legal text will deliver the intent of the Solution?*

We have not reviewed the legal text.

**Are there any errors or omissions in this Modification Report that you think should be taken into account?** *Include details of any impacts/costs to your organisation that are directly related to this.*

*"Article 38 of the TAR NC requires the reference price methodologies (amongst other things) to be published by 31 May 2019 and the resulting charges to be effective from the next tariff period i.e. for tariffs applicable from 1 October 2019. Therefore, the charge should be withdrawn from 1 October 2019."* (p.5)

TAR NC does not explicitly require tariffs to be effective from 1 October 2019. Instead, TAR NC notes that 31 May 2019 is the date for applying Chapter II Reference price methodologies, Chapter III Reserve prices and Chapter IV Reconciliation of revenue subject to national decision regarding the tariff period. Furthermore, it promotes stability in prices by clarifying that the tariffs applicable for the prevailing tariff period as of 31

May 2019 should not be changed immediately and must remain "until the end" of the period. This can be demonstrated by various EU members opting for the most suitable tariff periods for their markets. An example could be the Netherlands where the tariff period for which tariffs will be calculated according to the consulted RPM will be 2020.<sup>4</sup>

*"For the avoidance of doubt this Modification Proposal would remove OCR from 1 October 2019 and Modification 0678 would affect other tariffs including the possibility of a new "efficient by-pass" charge if desirable." (p.5)*

The 'effective date' is defined in the modification proposal as "If Authority decision made by end of July 2019: Proposed to be 1 October 2019" or "If Authority decision made after end of July 2019: Proposed to be the first day of the third month following the calendar month in which Authority makes its decision." This means the proposal does not restrict the effective date to be 1 October exclusively. Instead it acknowledges and accepts the risk of mid-year change which goes against the proposal's criticism of UNC 678 and rationale for implementing this proposal as an interim solution. This is a clear internal inconsistency.

### Please provide below any additional analysis or information to support your representation

In our view, the proposal does not present sufficient analysis or rationale for the change. Furthermore, the justifications and arguments used by the Proposer are contradictory to the actual proposal and legal text, specifically the following discrepancies can be noted:

- In the Proposer's perceived interpretation of TAR NC requirements, charges have to be effective on 1 October for the TSO and NRA to be compliant. The main justification for UNC 686 is stated to be compliance with TAR NC based on the above dates. However, the text of the modification itself allows for later implementation which dismisses the key rationale of this modification.
- The Proposer believes that NGG will be in breach of relevant legal requirements, specifically TAR NC, as the prevailing NTS Charging Methodology will not be compliant with TAR NC. Yet the modification itself proposes to address only one element of existing charging arrangements and acknowledges that the prevailing NTS Charging methodology will remain until UNC 678 or its alternative is introduced. This implies that the proposal will not deliver compliance with TAR NC since the prevailing methodology will remain the same.

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<sup>4</sup>[http://www.acer.europa.eu/Official\\_documents/Acts\\_of\\_the\\_Agency/Publication/Agency%20Report%20-%20Analysis%20of%20the%20Consultation%20Document%20on%20the%20Gas%20Transmission%20Tariff%20Structure%20for%20the%20Netherlands.pdf](http://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Publication/Agency%20Report%20-%20Analysis%20of%20the%20Consultation%20Document%20on%20the%20Gas%20Transmission%20Tariff%20Structure%20for%20the%20Netherlands.pdf)