UNC Modification	At what stage is this document in the process?

UNC 0XXX:

New charge to reflect changes to the treatment of Entry Capacity Revenue from October 2020

01 Modification
02 Workgroup Report
03 Draft Modification Report
04 Final Modification Report

Purpose of Modification:

The purpose of the Modification is to create a new charge adjustment to effectively remove revenues recovered from daily interruptible and within-day Entry Capacity from Capacity Neutrality arrangements between 1st October 2020 up until the Solution End Date. Following implementation of UNC Modification 0678A on 1st October 2020 an increasing proportion of revenue is subject to neutrality so there is a need to urgently review the application of the current Capacity Neutrality arrangements from 1st October 2020 as the redistribution of some sources of such revenues was not appropriate.

The Proposer recommends that this Modification should be:

- treated as urgent and should proceed as such under a timetable agreed with the Authority

High Impact:

All parties that hold NTS Entry Capacity and National Grid NTS

Medium Impact:

None

Low Impact:

None

Contents

Timetable

The Proposer recommends the following timetable:	
Modification Proposal sent to Ofgem	[07 December 2020]
Ofgem decision on Urgency	[08 December 2020]
Modification Proposal issued for consultation	[08 December 2020]
Consultation Close-out for representations	[11 December 2020]
Final Modification Report available for Panel	[15 December 2020]
Modification Panel recommendation	[17 December 2020]
Final Modification Report issued to Ofgem	[17 December 2020]

Any questions?

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1 Summary

What

The UNC TPD (Section B2.13) and EID (Section B11.5) currently details that the revenues received by National Grid from Entry Capacity Charges in respect of within day Daily NTS Entry Capacity and Daily Interruptible NTS Entry Capacity ('**Relevant Entry Capacity**') are subject to Capacity Neutrality arrangements whereby National Grid NTS is held cash neutral by the subsequent return of such revenues to Users of the NTS.

As a consequence, the revenue that National Grid is entitled to recover from the provision of such Entry Capacity on the NTS has to be recovered from Users' procurement of other Entry Capacity products (i.e. those that are not subject to the aforementioned neutrality arrangements).

Why

The NTS Charging Methodology in place prior to October 2020 facilitated recovery of National Grid's Allowed Revenue principally from flow based 'commodity' charges and long term capacity products. Indeed, the vast majority of short-term Entry Capacity was available at low or zero reserve price's (i.e. interruptible / offpeak / within day firm). The socialisation of such relatively low revenue values under the Capacity Neutrality mechanism therefore had no material impact on recovery of National Grid's Allowed Revenue.

Following the implementation of the current NTS Charging Methodology on 1st October 2020 an increasing proportion of overall revenue is from Relevant Entry Capacity products which now have a higher unit cost compared to pre-October 2020. For instance interruptible / off peak capacity is now priced at 90% of the equivalent firm Capacity reserve price, as opposed to having a reserve price of zero prior to October 2020. The consequence of this is that a material proportion of revenue from Entry Capacity is now subject to Capacity Neutrality and therefore does not contribute to the collection of National Grid's Allowed Revenue. This has resulted in a significant proportion of revenue being distributed back to Users which is not consistent with the wider aims of the charging regime to secure effective competition and to take account of developments in the transportation business, specifically the increase in revenue subject to neutrality arrangements.

If no action is taken to address the issue, the un-anticipated scale of revenue subject to neutrality arrangements is expected to result in a significant under recovery of National Grid's Allowed Revenue in Formula Year 2020/21 and require a material proportion of revenue to be recovered via the Transmission Services Revenue Recovery Charge (TSRRC). This will increase overall price volatility for Users if this is not addressed in a timely manner.

How

It is proposed that a calculation is completed to effectively remove the revenues received by National Grid from Relevant Entry Capacity charges from the Capacity Neutrality arrangements between 1st October 2020 and the implementation date. This will have the effect that all Entry Capacity invoiced in this period will contribute towards the efficient recovery of National Grid's Allowed Revenue (subject to clarification of the Licence position) and will rectify the outcomes of the defect identified in the arrangements as a consequence of the increased revenues subject to neutrality. The consequential charges will be levied to relevant Users after the implementation date.

2 Governance

Justification for Urgency

This Modification should be treated as urgent and should proceed under a timetable approved by the Authority. A proposed timeline is provided in the 'Timetable' section of this Proposal.

Urgent status is sought on the basis that this is an imminent issue and as such there is a need to address this issue as soon as practicable to minimise the impact on those paying Transportation Charges and those who are paying into Capacity Neutrality and receiving a proportion of the redistribution thereof and mitigate a significant commercial impact. Urgent resolution seeks to minimise the cumulative impact from October 2020 on Users. Impacts will vary across Users and timely resolution would reduce the overall impact in terms of the duration that the charge is necessary to remedy between 1 October 2020 and the implementation date. The longer the issue remains unaddressed will increase the likely impact on Users as it impacts the amount of the required charge to adjust back to 1 October 2020. The longer the period, the larger the amount that would need to be corrected via the proposed additional charge.

Urgent status is sought on the basis that there is a material benefit (to all parties that pay NTS Transportation Capacity Charges) in addressing this issue as soon as practicable within the current Formula Year. To this extent, the need for this issue to be address is being driven by an imminent date related issue in terms of the benefits that would be realised by addressing the issue as soon as practicable i.e. minimisation of the cumulative revenue from Relevant Entry Capacity which will have been subject to Capacity Neutrality from 1 October 2020 which can be in the order of £0.5 million per day (£15 million per month) (using October 2020 as the benchmark).

If this is not urgently addressed, this may result in continuation of the current anomalous arrangements necessitating a higher value one off adjustment to address. As set out elsewhere in this Proposal, the unanticipated increase in revenue subject to Capacity Neutrality has resulted in arrangements for revenue distribution via Capacity Neutrality that are not consistent with the objectives of the charging methodology as set out in Standard Special Condition A5(5) of the NTS Licence.

This revenue distribution takes effect as the cost of short term capacity is paid for by Users holding Relevant Entry Capacity, however this revenue is returned to all User via Capacity Neutrality. Therefore there may be distributional impacts on all Users if the method by which neutrality payments are returned to Users differs to the way they are recovered via the TSRRC.

As a result, this poses a significant commercial impact on all parties mentioned and will, in turn, have impacts for the reciprocal charges levied to customers and for interested stakeholders of NTS customers and how they in turn recover costs and charge for their recovery potentially across multiple years.

Justification for Authority Direction

This Modification Proposal is recommended for Authority direction as it is likely to have a material effect on commercial activities relating to the shipping, transportation and supply of gas because, if implemented, it is likely to have a material impact on the allocation of charges across Users.

Requested Next Steps

This Modification should:

- be considered a material change and not subject to self-governance
- be treated as urgent and should proceed as such under a timetable agreed with the Authority

3 Why Change?

Capacity Neutrality

The UNC TPD Section B2.13.2 provides that 'Relevant Capacity Revenues' are subject to the Capacity Neutrality mechanism set out in B2.13.3 to B2.13.7. The UNC EID Section B11.5 adds into Relevant Capacity Revenues certain revenues from the equivalent capacity at Interconnection Points.

Relevant Capacity Revenues include amounts payable to National Grid NTS by Users by way of Capacity Charges in respect of:

- Daily NTS Entry Capacity that is registered on the day (TPD Section B2.13.2(a)(i)(1));
- Daily Interruptible NTS Entry Capacity (TPD Section B2.13.2(a)(i)(2));
- any additional Firm NTS Entry Capacity made available in excess of Unsold NTS Entry Capacity (TPD Section B2.13.2(a)(i)(3));
- Monthly NTS Entry Capacity allocated by reason of the acceptance of a rolling monthly surrender offer (TPD Section B2.13.2(a)(i)(4)).
- NTS Entry Capacity allocated in any Interruptible Day-ahead Auction or Within-Day Auction (EID Section B11.5.1(a)(i)); and
- Interconnection Point Capacity comprising quantities subject to Surrender Offers or Withdrawal Offers (EID Section B11.5.1(a)(ii)).

The operation of the Capacity Neutrality arrangements means that National Grid NTS is held cash neutral by the subsequent return of such revenues to Users of the NTS.

As a consequence, the revenue that National Grid is entitled to recover from the provision of Entry Capacity on the NTS has to be recovered from Users procurement of other Entry Capacity products (i.e. those that are not subject to the aforementioned Capacity Neutrality arrangements).

Recovery of National Grid's Allowed Revenue

National Grid NTS is permitted by its Licence to recover amounts equal to its Allowed Revenue for provision of Transportation services to Users of its network (the NTS). The NTS Charging Methodology (UNC TPD Section Y Part A) sets out the principles applied by National Grid NTS in the setting of Transportation Charge rates to enable recovery of its Allowed Revenue in each Formula Year.

The NTS Charging Methodology in place prior to October 2020 ('*the previous Methodology*') facilitated recovery of National Grid's Allowed Revenue principally from flow based 'commodity' charges and long-term capacity products. Indeed, the vast majority of short-term capacity was available at low or zero unit cost (i.e. interruptible / offpeak / Within Day Firm). The socialisation of such relatively low revenue values under the Capacity Neutrality mechanism therefore had no material impact on recovery of National Grid's Allowed Revenue.

Due in part to the lack of predictability and instability of charge rates under the previous Methodology (which, due to capacity booking behaviours, resulted in an increasing reliance on flow-based commodity charges to recover revenues) and the need to comply with the newly introduced EU Tariff Code, Modification 0678A introduced a new NTS Charging Methodology ('*the new Methodology*') from 1st October 2020.

In order to comply with the EU Tariff Code, the new Methodology provided for a principally capacity-based charging regime which enables National Grid to recover the majority of its Allowed Revenue via this regime. Where in the Formula Year there is forecast to be a difference between Allowed Revenue and the aggregate amount expected to be collected from capacity charges, the new Methodology provides for a TSRRC to be applied to reconcile the two values. Accordingly, this charge is expected to make relatively small ‘fine tuning’ adjustments to overall collected revenue.

Impacts of Current Capacity Neutrality Arrangements

Following the implementation of the new Methodology on 1st October 2020 a material proportion of revenue from Entry Capacity is now classified as Relevant Capacity Revenue and therefore subject to Capacity Neutrality. Accordingly, such revenue does not contribute to the collection of National Grid’s Allowed Revenue.

If no action is taken to address the issue, the quantity of revenue that has been distributed back to industry between 1st October 2020 and the implementation date will not be addressed.

This issue needs to addressed as this revenue distribution via Capacity Neutrality was not consistent with the objectives of the charging methodology as set out in Standard Special Condition A5(5) of the NTS Licence. Specifically, it was not consistent with relevant methodology objectives:

- (b) *to take account of developments in the transportation business* on the basis that the prevailing Capacity Neutrality arrangements are no longer fit for purpose as they have not taken account of the implications of the increased proportion of revenue subject to neutrality arrangements from October 2020; and

- (c) *to facilitate effective competition between shippers* on the basis that the revenue distributed as a consequence of the operation of the prevailing Capacity Neutrality arrangements did not effectively target costs to those Users that accrued the benefit of the procurement of capacity.

This socialisation takes effect as aggregate revenues from Users contributing to Capacity Neutrality are not redistributed to the such Users in the equivalent proportions. This is because Capacity Neutrality as an overall ‘pot’ is redistributed on the proportions of User's Fully Adjusted Firm Available NTS Entry Capacity as system wide total of the Fully Adjusted Firm Available NTS Entry Capacity. Therefore, in summary there are distributional impacts on all Users if the method by which neutrality payments are returned to Users differs to the way they are recovered via the TSRRC.

By way of illustration to use two potential scenarios:

- A User may not have Capacity secured by auction (i.e. by trading the capacity in where the liability remains with the original holder) and therefore not pay any Capacity Charges direct to National Grid and will receive a proportion for the Capacity Neutrality redistribution;
- a User that is wholly an Interruptible Capacity User whereby the Interruptible Capacity is paid however would receive no proportion of the Capacity Neutrality redistribution as the redistribution is on the basis of a percentage of firm capacity.

Preferred Option to Address the Issue

Having considered the relative merits of the range of options to address this matter, our preferred solution is to create a charge to effectively reflect the removal of the relevant short-term Entry Capacity revenue from the Capacity Neutrality mechanism between 1st October 2020 and the implementation date. The historic rationale for inclusion of such revenue in Capacity Neutrality was to keep the System Operator neutral to constraint management costs. In practice, inclusion of the relevant revenues into the neutrality process was to offset Entry capacity constraint costs and therefore minimise cost exposure wherever possible to those multiple parties. Under this arrangement, the Allowed Revenue would be collected from other, arguably more predictable, revenue sources.

The proposed solution would retrospectively (back to 1st October 2020) align the treatment of revenues for long term and short-term Entry Capacity bookings respectively. Whilst under the previous Methodology there was a diverse range of other charges from which to collect Allowed Revenue (i.e charges for long term capacity, and flow- based commodity charges) differential treatment represented a logical approach. However, the move to a principally capacity based revenue recovery model from 1st October 2020 and the increased proportion of revenue subject to neutrality arrangements means that National Grid NTS is now of the opinion that the rationale for inclusion of Relevant Entry Capacity revenue in Capacity Neutrality is no longer valid and on this basis it was inappropriate for this revenue to be subject to Capacity Neutrality from 1st October 2020.

This would also remove the risk of having to utilise the TSRRC to recover a material proportion of National Grid's Allowed Revenue improving stability for those paying Transportation charges and address the re-distributional impacts identified above. This will ensure that this charge is appropriately limited to making relatively small 'fine tuning' adjustments to overall collected revenue, this being its true purpose.

To enable National Grid to take action to address this issue in a timely manner (thereby minimising the scale of the impact) it is necessary for the existing minimum notice period requirements for changes to the TSRRC rates to be waived for a TSRRC rate change as a consequence of the implementation of this Proposal. Retaining the requirement to provide a notice period of two months on this occasion would effectively delay the action National Grid could take to address this matter thereby requiring a higher value correction to address it.

4 Code Specific Matters

Reference Documents

UNC TPD Section B

UNC EID Section B

UNC TPD Section Y

UNC Modification 0678A

Knowledge/Skills

Knowledge of the treatment of capacity revenues and charging principles would be beneficial.

5 Solution

It is proposed that a new charge adjustment is created to effectively reflect that between 1st October 2020 and the Solution End Date (inclusive) the following sources of revenue relating to provision of Entry Capacity were not treated as Relevant Capacity Revenues and were not therefore subject to Capacity Neutrality:

- Daily NTS Entry Capacity (TPD Section B2.13.2(a)(i)(1)). Note this does not include Non-obligated Daily NTS Entry Capacity;
- Daily Interruptible NTS Entry Capacity (TPD Section B2.13.2(a)(i)(2));
- NTS Entry Capacity allocated in any Interruptible Rolling Day-ahead Auction or Within-Day Auction (EID Section B11.5.1(a)(i)).

The Solution End Date is the earlier of the Implementation Date of this Proposal and the first date on which the above listed Relevant Capacity Revenues are no longer treated as Relevant Capacity Revenues

For the avoidance of doubt, this Proposal has no *prospective* effect and does **not** propose that the above sources of revenue are not treated as Relevant Capacity Revenues from the Solution End Date.

It is also proposed that the minimum 2 months notice period for notification of a revision to Entry TSRRC or Exit TSRRC rates for a Gas Year (as per TPD Y3.3.3 and TPD B1.8.2(b)) are waived for a revision to such rates as a consequence of the implementation of this Proposal. Accordingly, on this occasion, the minimum notice period for changes to the above mentioned charge rates will be five Business Days (this being the minimum notice period for implementation of this Proposal as specified in section 8). For the avoidance of doubt, the effective date of the associated TSRRC rate change would be the first calendar day of a month.

6 Impacts & Other Considerations

Does this Modification impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

No such impacts have been identified

Consumer Impacts

There will potentially be an impact on different consumer groups but the Allowed Revenue (determined in line with National Grid's Licence) which is collected by National Grid NTS will not change in the event of implementation of this Proposal. This Proposal will essentially apportion Transportation costs to Users of the NTS in a way that National Grid believes is fairer, more proportionate and better aligned to the EU Tariff Code principles than the current revenue arrangements deliver with a greater proportion of Entry Capacity revenue (regardless of whether they are short or long terms products) contributing towards the collection of National Grid NTS' Allowed Revenue.

The nature of how the Users' Transportation charge liability is charged downstream from UNC arrangements will depend on how Users and other market participants structure their respective contracts and associated service charges.

Cross Code Impacts

No cross code impacts have been identified

EU Code Impacts

EU Tariff Code principles have been considered as part of this Proposal in respect of the stated purpose of the capacity Reference Price Methodology ("…*the methodology applied to the part of the transmission services revenue to be recovered from capacity-based transmission tariffs*") and Revenue Recovery charges ("…*levied for the purpose of managing revenue under- and over-recovery*").

This Modification maintains alignment with EU Code requirements.

Central Systems Impacts

There will be impacts on [Gemini and UK Link invoicing] systems. These impacts are being assessed.

7 Relevant Objectives

Impact of the modification on the Relevant Objectives:

Relevant Objective	Identified impact
a) Efficient and economic operation of the pipe-line system.	None
b) Coordinated, efficient and economic operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters.	None
c) Efficient discharge of the licensee's obligations.	Positive
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.	Positive
e) Provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards… are satisfied as respects the availability of gas to their domestic customers.	None
f) Promotion of efficiency in the implementation and administration of the Code.	None
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.	Positive

Demonstration of how the Relevant Objectives are furthered:

c) Efficient discharge of the licensee's obligations.

The proposed changes in this Modification better align the treatment of capacity revenues with the new Methodology and arrangements. Implementation of this Proposal would enable more efficient collection of Allowed Revenue (as provided for in the Special Conditions of our Licence) as opposed to the alternative approach of recovering a material proportion of National Grid NTS' Allowed Revenue via the TSRRC.

d) Securing of effective competition between relevant shippers;

The proposed changes in this Modification are expected to address the aforementioned revenue re-distributional impacts thus costs will be targetted at Shippers in a more appropriate manner which is more consistent with the Charging Methodology which was implemented on 1st October 2020, thereby enhancing effective competition.

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.

The proposed changes in this Modification will ensure that the revenue recovery arrangements better align with the EU Tariff Code principles relating to the purposes of the Reference Price Methodology and the TSRRC.

Section Y (Charging Methodology) Modifications

Impact of the modification on the Relevant Charging Methodology Objectives:	
Relevant Objective	Identified impact
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;	Positive
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;	None
b) That, so far as is consistent with sub-paragraph (a), the charging methodology properly takes account of developments in the transportation business;	Positive
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	Positive
d) That the charging methodology reflects any alternative arrangements put in place in accordance with a determination made by the Secretary of State under paragraph 2A(a) of Standard Special Condition A27 (Disposal of Assets).	None
e) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.	None

In the case of a modification to a NTS Charging Methodology, please state why the modification does not conflict with:

(i) paragraphs 8, 9, 10 and 11 of Standard Condition 4B of the Transporter's Licence; or

(ii) paragraphs 2, 2A and 3 of Standard Special Condition A4 of the Transporter's Licence;

Demonstration of how the Relevant Objectives are furthered:

a) charges reflect the costs incurred by the licensee in its transportation business

implementation of this Modification will adjust the retrospective revenue distribution (as a consequence of the operation of the prevailing Capacity Neutrality arrangements) from the implementation date back to 1st October 2020 as the prevailing arrangements did not enable National Grid to recover material amounts of revenue from the sale of capacity in its network.

b) properly takes account of developments in the transportation business

implementation of this Modification will effectively adjust the arrangements from the point at which increasing proportions of revenue being subject to neutrality arrangements was observed, this being 1st October 2020. On this basis, from this point the arrangements will have appropriately taken account of developments in the transportation business observed since this date.

c) facilitates effective competition between gas shippers and between gas suppliers

implementation of this Modification will adjust the retrospective revenue distribution (as a consequence of the operation of the prevailing Capacity Neutrality arrangements) from the implementation date back to 1st October 2020 as the prevailing arrangements did not effectively target cost incurred by National Grid in the provision of capacity to those Users that accrued the benefit of that capacity. Effective targeting of costs is a necessary cornerstone of competition.

8 Implementation

Implementation of this Proposal is requested as soon as practicable noting that implementation is required to take effect from the first calendar day of a month. On this basis, implementation is proposed to take effect from the first calendar day of the month following the date of the notice from the Authority directing the implementation of this Proposal (subject to a minimum period of 5 Business Days between the date of the Authority notice and the date of implementation).

For the purposes of illustration, the following table shows the expected Implementation Date in the event of a direction to implement this Proposal being issued in the timescales indicated:

Modification Proposal Direction Date	Implementation Date
up to and including 22 January 2021	1 February 2021
23 January 2021 to 19 February 2021 (inclusive)	1 March 2021
20 February to 24 March 2021 (inclusive)	1 April 2021

Update of the TSRRC rate will take effect at the earliest opportunity with a notice period of less than 2 months but no less than [5] business days.

The current Formula Year ends on 31st March 2021 hence a timely decision will enable National Grid NTS to address the historic impact of the defect (back to 1st October 2020) thereby enabling inclusion of the associated revenue from short term Entry Capacity in its Allowed Revenue at the earliest opportunity. This will therefore limit the scale of any change to Entry Capacity and TSRRC rates ahead of the end of the current Formula Year.

9 Legal Text

Text Commentary

Insert text here

Text

Insert text here

10 Recommendations

Proposer’s Recommendation

This Modification should be treated as urgent and should proceed as such under a timetable approved by the Authority.