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Modification proposal:	**Uniform Network Code (UNC) 454: Introduction of a Long Term Non Firm (LTNF) Capacity Product (UNC454)**		
Decision:	The Authority[1] has decided not to consent to this proposal[2]		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	20 June 2014	Implementation Date:	N/A

Background to the modification proposal

National Grid Gas NTS (NGG) is responsible for allocating capacity to enable users to put gas onto ('entry') or take gas off ('exit') the National Transmission System (NTS). It has a licence obligation to provide a certain level of 'firm'[3] capacity (the 'obligated capacity'). It also has an obligation in particular circumstances to provide firm capacity in excess of the obligated capacity within specified timescales. Such excess capacity is referred to as 'incremental capacity'. The obligation to provide this firm incremental capacity may be triggered by an incremental capacity signal arising from the annual entry capacity auction or exit capacity allocation processes. Some firm incremental capacity may rely upon a programme of network investment which may take longer to complete than is requested by customers.

NGG has received requests from its customers for a capacity product that would allow a customer to start using capacity earlier than the date of the firm incremental capacity delivery following the receipt of an incremental capacity signal from that customer.

The modification proposal

UNC454 seeks to introduce a capacity product described in the Final Modification Report (FMR) as "non firm". NGG proposes that this product, Long Term Non Firm (LTNF) capacity, can be offered before the effective date (and availability) of the firm incremental capacity allocated to the customer who has made an incremental capacity signal. Access to LTNF would be exclusive to such customers.

NGG envisage LTNF Capacity as a "non-firm" product in the form of Firm NTS Entry/Exit Capacity with an associated Buy Back Option Agreement for all days on which the LTNF capacity is held. NGG propose that LTNF may be held on a monthly basis and booked for up to one Gas Year.

LTNF entry capacity would be priced at the prevailing AMSEC reserve price[4] ; LTNF exit capacity would be priced at the prevailing actual exit capacity price. It could be bought back via the option agreement at the price paid.

NGG (the proposer) and the UNC Transmission Workgroup consider that the modification proposal has a positive impact on relevant objective (d), as set out in Standard Special

[1] The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.
[2] This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.
[3] Firm capacity provides users with a contractual right to flow gas onto or off the NTS. NGG cannot remove a user's right without compensation (usually by NGG buying back the firm capacity at a cost that can be specified by a user).
[4] System entry capacity is allocated by means of auctions as described in the UNC. This includes the Annual NTS Entry Capacity auction for Monthly NTS Entry Capacity (the AMSEC auction). This approach includes various reserve prices below which bids will not be accepted.

Condition (SSC) A11 (1) of NGG's Gas Transporters Licence. They also assessed that it may be inconsistent with relevant objective (g) and that it has no impact on the other objectives. NGG considers that the modification proposal has a positive impact on the relevant charging methodology objective as set out in SSC A5 (5) (b) of its Gas Transporter Licence and has no impact with respect to the other relevant charging methodology objectives.

UNC Panel[5] recommendation

At its meeting of 16 January 2014 the Panel voted unanimously to recommend implementation of UNC454. We received the Final Modification Report on 17 January 2014. On 19 February 2014, we directed that the FMR be revised and resubmitted to us[6], as we considered further clarity was needed on how the proposal was consistent with NGG's obligations in relation to non-discrimination, on the source and amount of LTNF that would be made available, and the order it would be curtailed in comparison with other products.

Following this further work, at its meeting on 15 May 2014 the Panel again voted unanimously to recommend implementation of UNC454 and the revised FMR was resubmitted to us for decision.

Our decision

We have considered the issues raised by the modification proposal and the FMR dated 15 May 2014. We have considered and taken into account the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR.

We have concluded that implementation of the modification proposal will not better facilitate the achievement of the relevant objectives of the UNC.[7]

Reasons for our decision

We have assessed the proposal against the UNC relevant objectives and the relevant charging methodology objectives below. We consider that it is neutral or has no impact on the other objectives.

We consider that the proposal could have a potential negative impact on relevant objective (c). We do not agree with the proposer and Workgroup's view that the modification proposal will better facilitate relevant objective (d). We agree with the proposer and Workgroup that the modification proposal is inconsistent with relevant objective (g). We also consider that it may be inconsistent with charging methodology objective (a) and we do not agree that the proposal would better facilitate charging methodology objective (b). The reasons for our views are set out below.

We note that the FMR inconsistent as to whether LTNF capacity is a firm or an interruptible product. In our view, the proposed capacity product falls within the

[5] The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.
[6] http://www.gasgovernance.co.uk/sites/default/files/unc454%20send%20back.pdf
[7] As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: 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

definition of an interruptible capacity product as defined in Regulation 715/2009/EC (the Regulation)[8]. In reaching our decision, we have considered the responses to the consultation on the modification proposal. Four consultation responses were received. Two supported implementation and two offered qualified support. One of the two respondents that offered qualified support wanted the charges payable for LTNF to contribute to the User Commitment. This is discussed further below under relevant charging methodology objective (b) below.

Relevant Objective (c) Efficient discharge of the licensee's obligations

The proposer and Workgroup considered the modification proposal to have no impact upon Relevant Objective (c). However, we consider that the modification proposal could have a negative effect generally on the efficient discharge of NGG's licence obligations for the reasons given under the charging objective assessment below.

In our 19 February 2014 direction to revise and resubmit the FMR, we also sought evidence or criteria to justify the release of discretionary capacity to certain users on an exclusive basis in the light of NGG's obligation not to discriminate unduly between users. In response to this, the revised FMR sets out NGG's view that "LTNF service is available to all users, should they meet the criteria and wish to use it" and therefore NGG did not believe it to be discriminatory. We continue to be concerned that LTNF has the potential to be discriminatory. We have not been convinced that LTNF would be available to all users for the following reasons -

- If NGG is able to provide capacity above baseline before it has built new investment, then this may suggest that there is spare capacity on the network. If that is the case then, while recognising that the release of non obligated capacity is at NGG's sole discretion, the release of any such capacity should be made available to all users and not just those who have prequalified by making an incremental signal.

- Potential users of LTNF may not be able or desire to pre-qualify for various reasons, e.g. they may not want or be able to make the commitment required for an incremental signal/ firm investment, but this does not mean that they would not be interested in an interruptible product such as LTNF.

- It is not clear when the LTNF capacity will be available. If availability occurs after an incremental signal is made, then NGG should provide justification for making it exclusive to predetermined users in preference to other users. If it is available before the incremental signal is made, it should be made available to all users at that time.

Potential different treatment of users arising from the release of capacity on an exclusive basis, may not itself be a reason to reject the modification proposal if there is objective justification for different treatment and it does not work against the interests of consumers. However, in our opinion, neither the UNC Panel nor the proposer has provided sufficient justification or evidence to support restricting the release of LTNF capacity to users who have prequalified, by making an incremental capacity signal, in preference to other users.

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[8] Regulation 715/2009/EC defines interruptible capacity as "gas transmission capacity that may be interrupted by the transmission system operator in accordance with the conditions stipulated in the transport contract." http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:211:0036:0054:en:PDF

Relevant 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.

The proposer and the Workgroup consider that the modification proposal would allow customers to choose to connect to the NTS earlier than is currently permitted under the UNC. This potentially increases the supply to the market and provides additional demand which Shippers could compete to supply, thereby furthering effective competition between Shippers. We agree that appropriate arrangements to allow earlier access to the NTS than would otherwise be permitted may be beneficial to competition. However, we remain concerned that allowing exclusive access to LTNF to certain predetermined users is potentially discriminatory and therefore may not facilitate the securing of effective competition between shippers.

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

The FMR noted that this modification proposal "may be inconsistent" with this relevant objective. We agree with this statement in the FMR as the pricing of this capacity product does not reflect the probability of interruption as required by Article 14(1)(b) of the Regulation. The FMR in fact notes that the pricing approach for this capacity product is identical to existing firm products that can be subject to buy-back arrangements. The price of this interruptible capacity is required to reflect the probability of interruption. In the FMR NGG says that the requirement in Article 14(1)(b) applies to interconnection points only and not aggregate system entry points or NTS exit points where long term non firm capacity is to be made available. We do not agree with NGG's interpretation. Article 14(1)(b) is not limited to interconnection points and therefore applies to all entry and exit points on the system. Therefore, the long term non firm capacity product cannot be priced as a firm product. The price of this interruptible capacity is required to reflect the probability of interruption. We note that in its response, NGG "have emphasised that alternative pricing could not be implemented at the present time due to IS (sic) system constraints". It is open to the proposer to demonstrate that the current pricing proposals could be considered to reflect the probability of interruption, or to amend the pricing proposals to be compliant.

SSC A5 (5) (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

The proposer and Workgroup considered the modification to have no impact upon this relevant charging methodology objective but did not provide any evidence of this. Interruptible use does not impose any fixed costs of investing in capacity (although we acknowledge that other costs may apply such as investment in information systems). Firm use on the other hand, generally requires an investment in order to guarantee uninterruptible use. We note that LTNF capacity, as an interruptible product, is priced in a manner that is consistent with that of a firm product and at prevailing firm capacity prices. We are therefore not convinced that the modification has no impact on this relevant objective.

SSC A5 (5) (b) That, so far as is consistent with sub-paragraph (a), the charging methodology properly takes account of developments in the transportation business

The proposer and Workgroup considered that consequential changes to the transportation charging methodology were required to support the modification. As such, the proposed changes facilitated achievement of this relevant objective by properly taking account of this development in the transportation business. One respondent to the consultation proposed that the LTNF charges should contribute to User Commitment. We agree with the proposer that as an interruptible product (and as Non-obligated capacity), LTNF charges should not contribute to user commitment. We agree that consequential changes may be required in order to introduce appropriate arrangements to allow earlier access to the NTS than would otherwise be permitted; however, primarily for those reasons given in relation to Relevant Objective (g), we are not convinced that the charging changes envisaged for this modification would better facilitate the relevant objective.

Conclusion

While we share the proposer's and industry's views that appropriate arrangements to allow earlier access to the NTS than would otherwise be permitted may better facilitate the relevant objectives, we do not believe that UNC454 achieves this. In particular, we are concerned that the modification proposal is potentially discriminatory. We are also concerned over the ambiguity as to whether LTNF is a firm product or an interruptible product. In reaching our decision, we considered LTNF to be an interruptible product but were concerned that it was packaged and priced as a firm product. As a result, the pricing proposed is not consistent with the EU pricing requirements for interruptible capacity.

We would welcome a new modification proposal that would allow earlier access to the NTS. We would expect this new proposal to properly address the issues raised above, namely undue discrimination, whether the product is interruptible or firm, and appropriate pricing. We note that the introduction of PARCA[9] arrangements may facilitate the opportunity to raise such a new modification proposal.

Andy Burgess, Associate Partner, Transmission and Distribution Policy

Signed on behalf of the Authority and authorised for that purpose.

[9]UNC modification proposals for the Introduction of the Planning and Advanced Reservation of Capacity Agreement (PARCA)