

Modification proposal:	Uniform Network Code (UNC) Modification 0494: Imbalance Charge amendments required to align the UNC with the Network Code on Gas Balancing of Transmission Networks		
Decision:	The Authority ¹ directs that this proposal be made ²		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	23 September 2014	Implementation Date:	1 October 2015

Background to the modification proposal

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

In response, a suite of legally binding European Union (EU) legislation, referred to as the Third Package⁴, on European electricity and gas markets was introduced and adopted on 13 July 2009. The Third Package was transposed into GB law by Regulations that came into force on 10 November 2011.⁵

The Third Package created a new legal framework to promote cross-border trade. It requires a number of legally binding Guidelines and 'Network Codes' to be established and implemented. 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.⁶ These EU legislative requirements take priority over GB domestic legislation and associated regulations and codes, including the UNC.

One such Network Code is the The Gas Balancing of Transmission Networks Network Code⁷ (BAL), which was published in the Official Journal of the European Union on 27 March 2014 and applies from 1 October 2015. BAL aims to facilitate cross-border gas trade and the further development of competitive and efficient wholesale gas markets in Europe. The code requires the use of non-discriminatory and transparent balancing systems, which are of particular importance for new market entrants.

Much of BAL closely reflects the existing GB balancing regime set out in the Uniform Network Code (UNC). However, there are some provisions for which GB is not currently in compliance, and so certain changes to the GB balancing regime must be made in order

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 <http://ec.europa.eu/competition/sectors/energy/inquiry/>

⁴ 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").

⁵ Article 6 (Establishment of network codes) of the Gas Regulation sets out the process for establishing EU wide network codes for gas.

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

⁷ 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.

to fully comply with the Third Package legal requirements. One area where there are BAL provisions which need to be reflected in the GB regime relates to the methodology for calculating the imbalance price for the buying and selling of gas, as the BAL calculation differs from the methodology currently contained in the UNC.

A network user is said to be out of balance when their input volumes to the system are not equal to their offtakes. When this occurs, the Transmission System Operator (TSO), which includes National Grid Gas plc (NGG), as operator of the National Transmission System, may take a balancing action to ensure balance across the system as a whole.⁸ When the user has inputted more gas than they have offtaken, they are deemed to be "long" and the System Marginal Price (SMP) Sell⁹ will apply, as the user will "sell" gas to the TSO. When the user has offtaken more gas than they inputted, they are deemed to be "short" and the SMP Buy¹⁰ will apply, as they will "buy" gas from the TSO.

The modification proposal

On 21 August 2014 the Authority received the Final Modification Report (FMR) for UNC Modification 494 (UNC494) which seeks to implement changes to the imbalance charges¹¹ calculation methodology within the UNC to facilitate compliance with the requirements of the European (EU) legislative changes set out in BAL with effect from 1 October 2015.

The proposer, NGG, seeks to implement two amendments to the UNC calculation methodology for SMP Buy and SMP Sell.

At present, when the TSO undertakes a market balancing action, SMP Buy and Sell can be set by the Balancing Action Offer Price¹², taken by the TSO during a given day 'D'. This means that SMP Buy can be set by NGG either buying or selling gas, and SMP Sell can also be set by the TSO either buying or selling gas.

Article 22(2) of BAL requires that, where SMP Buy is set by a market balancing action, this must be a buy action; and where SMP Sell is set by a market balancing action, this must be a sell action. Accordingly, the TSO has proposed the following two changes to UNC Transportation Principal Document Section F 1.2 System Prices (insertions are underlined):

⁸ "Balancing action" is defined in Article 3(2) of Gas Balancing of Transmission Networks Network Code.

⁹ Currently defined in UNC Transportation Principal Document Section F.1.2 as "the lesser of:

(i) the System Average Price less the Default System Marginal Price; and (ii) the price in pence/kWh which (subject to Section D4.1.4, 4.1.5(b) and 4.1.7) is equal to the lowest Balancing Action Offer Price in relation to a Market Balancing Action taken for that Day"

(http://www.gasgovernance.co.uk/sites/default/files/TPD%20Section%20F%20-%20System%20Clearing,%20Balancing%20Charges%20and%20Neutrality_14.pdf)

¹⁰ Currently defined in UNC Transportation Principal Document Section F.1.2 as "the greater of:

(i) the System Average Price plus the Default System Marginal Price; and (ii) the price in pence/kWh which (subject to Section D4.1.4, 4.1.5(a)) is equal to the highest Balancing Action Offer Price in relation to a Market Balancing Action taken for that day"

(http://www.gasgovernance.co.uk/sites/default/files/TPD%20Section%20F%20-%20System%20Clearing,%20Balancing%20Charges%20and%20Neutrality_14.pdf)

¹¹ Where Shipper Users do not balance their portfolios, the GB TSO may take Market Balancing Actions. The costs of these actions are passed back through to Shipper Users via Balancing Neutrality Charges. "Shipper User" is defined in UNC General Terms Section B2.2.1(a)

(http://www.gasgovernance.co.uk/sites/default/files/GTB%20-%20General_5.pdf)

¹² Currently defined in UNC Transportation Principal Document Section D.1.4 as "Balancing Action Offer Price" is the Market Offer Price or Non-Trading System Offer Price (as the case may be) in respect of a Balancing Transaction (http://www.gasgovernance.co.uk/sites/default/files/TPD%20Section%20D%20-%20Operational%20Balancing%20and%20Trading%20Arrangements_9.pdf)

1.2.1 Subject to paragraphs 1.2.2 and 1.2.5, for each Day:

(a) the "**System Marginal Buy Price**" is the greater of:

(i) the System Average Price plus the Default System Marginal Price; and
(ii) the price in pence/kWh which (subject to Section D4.1.4, 4.1.5(a)) is equal to the highest Balancing Action Offer Price in relation to a Market Balancing Buy Action taken for that Day;

(b) the "**System Marginal Sell Price**" is the lesser of:

(i) the System Average Price less the Default System Marginal Price; and
(ii) the price in pence/kWh which (subject to Section D4.1.4, 4.1.5(b) and 4.1.7) is equal to the lowest Balancing Action Offer Price in relation to a Market Balancing Sell Action taken for that Day;

UNC Panel¹³ recommendation

At its meeting of 21 August 2014, the UNC Panel: (i) considered the workgroup report on UNC494 and the three responses to the industry consultation; and, (ii) voted whether to recommend implementation of the modification proposal. The UNC Panel voted unanimously to recommend implementation of the modification on the basis that it better facilitated the achievement of UNC Relevant Objective (g).

Our decision

We have considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 21 August 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.¹⁴ We have concluded that:

1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC¹⁵; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties.¹⁶

Reasons for our decision

The three respondents to the industry consultation expressed unanimous support for implementing the proposed modification on the basis that UNC494 better facilitates UNC relevant objective (g). We agree with the proposer, the UNC Panel and those respondents who commented that the modification proposal should be considered to better facilitate achievement of relevant objective (g). We consider it is neutral or has no impact in relation to the other relevant objectives.

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

¹⁴ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.co.uk

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

¹⁶ 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.

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

As noted by the proposer, the UNC Panel and consultation respondents, UNC494 introduces changes which will align the UNC with the new EU requirements from BAL for setting imbalance prices. These requirements are contained within a relevant legally binding decision of the European Commission ie BAL. We therefore agree that implementation of UNC494 would better facilitate relevant objective (g).

Implementation date

UNC494 suggests an implementation date of 1 October 2015 so as to align with the relevant implementation deadline under BAL. We agree with this approach as it will aid compliance with BAL. We therefore agree with the suggested implementation date contained in the FMR for UNC494 that the modifications it proposes will take effect from 1 October 2015.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority hereby directs that modification proposal UNC494: *'Imbalance Charge amendments required to align the UNC with the Network Code on Gas Balancing of Transmission Networks'* be made.

Rob Mills

Interim Associate Partner, Wholesale Markets

Signed on behalf of the Authority and authorised for that purpose