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Modification proposal:	**Uniform Network Code (UNC) 539: Removal of NTS Exit Commodity Charges for Distributed Gas (UNC539)**		
Decision:	The Authority[1] has decided to reject this modification[2]		
Target audience:	UNC Panel, Parties to the UNC and other interested parties		
Date of publication:	19 November 2015	Implementation date:	n/a

Background

Under the current gas transportation charging methodology, National Grid Gas Transmission (NGGT) applies National Transmission System (NTS) exit commodity charges[3] to all gas offtaken at distribution network (DN) supply points. Some gas enters the gas distribution networks (GDNs) at embedded DN entry points, which means it does not physically enter the NTS and only uses the GDNs' networks for transportation to the DN supply points.

National Grid Gas Distribution (NGGD) raised UNC508[4] on 4 July 2014. The change sought to revise the charging methodology in respect of DN entry points to provide a rebate equivalent to the level of the NTS exit commodity charges for gas that enters at embedded DN entry points. On 24 October 2014, the Joint Office gave notice that NGGD had withdrawn the proposal. NGGD provided a report setting out the reasons for the decision to withdraw UNC508.[5]

The modification proposal

UNC539 was raised by Barrow Shipping Limited and proposes the change previously raised under UNC508. Under the proposed change:

- NGGT would continue to apply NTS exit commodity charges to all gas offtaken at DN supply points; and
- GDNs would provide a rebate at the DN entry point to offset the charges for gas entered at that DN entry point.

The proposer considers that UNC539 will have a positive impact on relevant objectives a) and c)[6] by making changes to reflect that gas entered onto the GDNs' networks does not physically enter the NTS.

[1] 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.
[2] This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.
[3] This charge is levied when NGGT forecasts that the exit capacity revenue will be below target revenue.
[4] Revised Distributed Gas charging Arrangements:
http://www.gasgovernance.co.uk/sites/default/files/Modification%200508%20v1.0.pdf
[5]http://www.gasgovernance.co.uk/sites/default/files/Withdrawal%20Report%20by%20Proposer%200508%20v1.0.pdf
[6] See below for objectives.

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UNC Panel[7] recommendation

At the UNC Panel meeting on 15 October 2015, the UNC Panel considered that UNC539 would not better facilitate the UNC objectives and the Panel therefore did not recommend its approval.

Our decision

We have considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 15 October 2015. We have considered and taken into account the responses to the industry consultation on the modification proposal which are attached to the FMR.[8] We have concluded that implementation of the modification proposal will not better facilitate the achievement of the relevant methodology objectives of the UNC.[9]

Reasons for our decision

We consider this modification proposal will not better facilitate UNC relevant methodology objectives (a) or (c) and has a neutral impact on the other relevant methodology objectives.

(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 considered UNC539 better facilitates this objective because they do not believe it is cost reflective to apply the NTS exit commodity charge to gas that is solely transported within a GDN network.

Some respondents suggested that there was not enough evidence to confirm that NTS exit commodity charges should be fully offset for distributed gas because it is not clear what costs NTS exit commodity charges cover. They also suggested that there is a potential mismatch between DN entry and exit users, which could result in shippers receiving a rebate for distributed gas without having paid NTS exit commodity charges at a DN supply point.

In addition, although they do not physically use the NTS, we consider that it can provide benefits to shippers of distributed gas by providing:

- The pressure differential at the NTS exits required to flow gas in the distribution networks; and
- the blending process to ensure gas quality is consistent and meets current standards.

A number of respondents also considered that this change will not be more cost reflective because it introduces a cross subsidy between NGGT and the GDNs. This is because NGGT will continue to recover NTS exit commodity charges directly from shippers while the rebate to shippers for distributed gas will be provided by the GDNs.

[7] The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.
[8] UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.co.uk
[9] As set out in Standard Special Condition A11(1) of the Gas Transporters Licence: https://epr.ofgem.gov.uk//Content/Documents/Standard%20Special%20Condition%20-%20PART%20A%20Consolidated%20-%20Current%20Version.pdf

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Although the values are currently forecast to be small, they will need to be recovered from the GDNs' other customers.

In addition, we note that the proposer of UNC508, which was a precursor to UNC539, identified a number of issues to support their decision to withdraw the previous modification. We advised the workgroup that they would need to properly address these issues in their evidence to support UNC539.

We agree with the principle that shippers should not pay NTS exit commodity charges if they do not benefit from the services that those charges cover. We also consider that it might be appropriate for some level of rebate to be offered where it is possible to confirm that the shipper who pays NTS exit commodity charges for distributed gas is the same shipper who will receive the rebate for the distributed gas at the DN entry point.

However, we do not consider that the workgroup has sufficiently demonstrated that the proposed solution will actually achieve the principle that a customer should not pay for use of the NTS, if, in fact, they do not derive any benefit from it.

We consider that, by requiring the GDNs to provide a rebate to offset charges levied by NGGT, this solution may actually have a negative impact on this objective because they are not costs the GDNs have incurred in its transportation business. We agree with respondents who have suggested that UNC539 introduces a cross subsidy, which the GDNs will need to recover from their other customers.

We note the proposer considered that the proposed solution is similar to rebate arrangements introduced under UNC391.[10] However, there is an important difference between the rebate arrangements established under UNC391 compared to those proposed under UNC539 – the UNC391 rebate offsets NTS exit capacity charges, which are charged to the GDNs, rather than directly to shippers.

For the reasons set out above, we do not consider that UNC539 better facilitates this objective.

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

We note that several respondents considered that UNC539 had a negative impact on this objective. We consider that the proposal attempts to take account of developments in the transportation business, as it addresses issues identified for distributed gas. However, as noted above, we do not consider the workgroup provided sufficient evidence to support this proposal. Therefore, we consider UNC539 to be neutral in regard to this objective.

(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

The FMR sets out that the proposal better supports this objective because it would result in a reduction in the cost to transport gas sourced through DN entry points. This may facilitate the development of distributed gas sources and effective competition between

[10] http://www.gasgovernance.co.uk/0391

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gas shippers. The FMR also sets out that better cost reflectivity would support the development of effective competition.

We agree that more cost reflective charges would support competition for shippers transporting distributed gas. However, as noted above, we are not convinced that the proposal will result in more cost reflective charges. Also, although UNC539 might result in lower costs to transport gas sourced through DN entry points because a shipper would receive a rebate from the GDN, if it is not possible to confirm it is the same shipper who paid NTS exit commodity charges at the DN supply point, then it may actually distort competition between shippers.

<u>Other considerations</u>

The proposer suggested that UNC539 is consistent with the charging methodology for embedded generation on the electricity distribution (ED) networks. We do not agree that they are directly comparable. Eligible ED customers receive a p/kWh credit for energy exported because it is considered that this can offset demand and potentially defer or reduce the need for reinforcement on the ED networks. UNC539 does not propose to provide a credit for a benefit provided to the network but to provide a rebate to offset a charge the proposer believes certain customers should not have to pay because it relates to a network they may not use.

Finally, we note that a number of respondents indicated they supported the underlying principle for UNC539 but suggested that there are other solutions that could be considered, including changes to NGGT's charges. If industry parties believe there is an issue with the current methodology that needs to be addressed, then we expect them to seek to identify a solution and provide robust evidence in support of any proposed change.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters licence, the Authority has decided that modification proposal UNC539: *'Removal of NTS Exit Commodity Charges for Distributed Gas'* should not be made.

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Signed on behalf of the Authority and authorised for that purpose

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