

Modification proposal:	Uniform Network Code (UNC)541A: Removal of uncontrollable UNC charges at ASEPs which include sub-terminals operating on a 06:00 to 06:00 Gas Day via setting charges which arise solely as a result of the different Gas Day timings to zero Uniform Network Code (UNC)541B: Removal of uncontrollable UNC charges at ASEPs which include sub-terminals operating on a 06:00 to 06:00 Gas Day via ex-post adjustments to capacity, balancing, scheduling and INS charges.		
Decision:	The Authority ¹ has decided to reject these modifications ²		
Target audience:	UNC Panel, Parties to the UNC and other interested parties		
Date of publication:	26 May 2016	Implementation date:	n/a

Background

The Third Package is a suite of European legislation to promote cross-border trade and improve competition between Member States. The Gas Regulation³ is one of the instruments that make up the Third Package. European Network Codes (ENCs) are EU laws that apply to one or more parts of the energy sector. These are made under the Gas Regulation and supplement it. They promote liquid markets, efficient use of cross-border transmission capacity and integration of markets: this includes a common start and end time for the gas day. Two of the ENCs contain the definition of the gas day:

- Capacity Allocation Mechanisms in Gas Transmission Systems ENC (CAM)⁴ defines the gas day as *"the period from 5:00 to 5:00 UTC⁵ the following day for winter time and from 4:00 to 4:00 UTC the following day when daylight saving is applied"*. CAM was implemented as planned on 1 November 2015.
- The Gas Balancing of Transmission Networks ENC (BAL)⁶ uses the definitions of 'gas day' from CAM. BAL applies to balancing zones, which include the downstream sector (ie. the onshore gas industry). BAL does not therefore apply to arrangements "upstream" of the transmission system (ie. offshore). BAL has been implemented as planned on 1 October 2015.

ENCs are binding EU legislation and so take priority over domestic legislation. In March 2014 the Authority approved modification proposal UNC461⁷, which changed the gas day definition in the UNC to align with the definition of gas day in CAM. From 1 October 2015, the GB's gas day downstream changed from 06:00-06:00 to 05:00-05:00 UTC.

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 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.

⁴ Commission Regulation (EU) No 984/2013 establishing a Network Code on Capacity Allocation Mechanisms in Gas Transmission Systems and supplementing Regulation (EC) No 715/2009 of the European Parliament and of the Council.

⁵ Coordinated Universal Time.

⁶ Commission Regulation (EU) No 312/2014 of 26 March 2014 establishing a Network Code on Gas Balancing of Transmission Networks.

⁷ Our decision letter can be found on our website:

https://www.ofgem.gov.uk/sites/default/files/docs/2014/03/unc0461_d.pdf

However, BAL does not impose direct responsibilities on parties operating upstream of the national transmission system (NTS). Some UK gas beach processing terminals have adjusted their procedures in order to align with the new times of the gas day. Other UK beach terminals have decided to continue operating on a 06:00-06:00 gas day⁸.

For those Users operating at a GMT Terminal, the Transmission System Operator (TSO⁹) is still required to calculate imbalance charges based on their 05:00-05:00 User Daily Quantity Input (UDQI). In September 2015, Option A, a solution agreed by the upstream industry to derive UDQIs at a GMT Terminal, was implemented¹⁰.

In the Final Modification Report (FMR), it is stated that Users from GMT Terminals will continue to nominate based on the information they have on their 06:00-06:00 flows, because they state that they do not have sufficient information on their 05:00-05:00 flows before and during the gas day. This behaviour exposes them to the risk of incurring UNC charges¹¹ in respect of any difference between the 06:00-06:00 and the 05:00-05:00 gas flows.

The modification proposals

On 16 July 2015 EdF Trading raised UNC Modification Proposal 541 (UNC541)¹², BP raised alternative Modification Proposal UNC541A¹³ and Gazprom raised alternative Modification Proposal UNC541B¹⁴. On 15 December 2015 Proposal UNC541 was withdrawn. On 21 April 2016 the Authority received the FMR for UNC541A/B.

UNC541A and UNC541B seek to achieve the removal of those UNC Charges incurred as a result of the one hour difference between the upstream and the downstream gas days, by those Users inputting gas into the NTS from GMT Terminals. The FMR defines these charges as 'Time Shift Charges' and for ease of reference we will be using the same definition in this decision letter.

Both modification proposals propose to adjust the UNC Charges to remove from their calculation the volume attributable to the difference between the 06:00-06:00 and the 05:00-05:00 gas days. The only difference between the two alternative proposals is the point at which the calculation is performed and any relevant reimbursement is applied (ie. before or after invoicing all Users).

As per the existing UNC rules on Capacity and Balancing Neutrality, the money lost or gained as a result of these recalculations of the UNC charges will be redistributed to all Users (ie. not only those at GMT Terminals).

⁸ The Final Modification Report (FMR) defines the gas beach terminals continuing to operate on a 06:00-06:00 gas day as 'GMT Terminals' and we will use the same terminology in this decision letter. We will also refer to UK beach terminals which moved to the 5:00-5:00 gas day as non-GMT Terminals.

⁹ National Grid Gas plc (NGG) was designated as the gas TSO on 19 June 2012. Our decision can be found here: <https://www.ofgem.gov.uk/publications-and-updates/certification-decision-national-grid-gas-plc>

¹⁰ We understand this Option A is a scaling algorithm to derive the 05:00-05:00 UDQI at GMT Terminals, by using the aggregated daily quantities, for the 05:00-05:00 and the 06:00-06:00 time periods, and the Users' 06:00-06:00 allocations based on upstream Claims. Ofgem does not regulate the upstream industry and had no role in implementing this algorithm.

¹¹ The UNC charges referred to are: imbalance, capacity overrun, scheduling and incentivised nominations charges (the UNC Charges).

¹² Removal of uncontrollable UNC charges at ASEPs which include sub-terminal operating on a 06:00 to 06:00 Gas Day via an ex-ante quantity adjustment.

¹³ Removal of uncontrollable UNC charges at ASEPs which include sub-terminal operating on a 06:00 to 06:00 Gas Day via setting charges which arise solely as a result of the different Gas Day timings to zero.

¹⁴ Removal of uncontrollable UNC charges at ASEPs which include sub-terminal operating on a 06:00 to 06:00 Gas Day via ex-post adjustments to capacity, balancing, scheduling and INS charges.

BP and Gazprom (the Proposers) have stated that implementing one of these alternative modification proposals would better facilitate the UNC relevant objectives (d)¹⁵ and (g)¹⁶, as they would prevent Users of GMT Terminals incurring what they consider to be “unearned” charges. They also argue that the modifications would restore what they state to be the correct financial incentives to balance and would avoid discrimination of Users at GMT Terminals, and cross-subsidisation by them of all other Users.

UNC Panel¹⁷ recommendation

At the UNC Panel meeting of 21 April 2016 a majority¹⁸ of the Panel, voted that both UNC541A and UNC541B would better facilitate the UNC objectives and the Panel therefore recommended approval of UNC541A and UNC541B.

Our decision

We have considered the issues raised by the modification proposals and FMR dated 21 April 2016. We have considered and taken into account the responses to the industry consultation on the modification proposals, which are attached to the FMR¹⁹, and the additional confidential response sent to us directly. We have concluded that:

- implementation of either of the modification proposals will not better facilitate the achievement of the relevant objectives of the UNC.²⁰
- directing that either of the modifications be made would not be consistent with our principal objective and statutory duties.²¹

Reasons for our decision

We consider that both of these modification proposals will not better facilitate UNC relevant objectives (c), (d), (f) and (g) and will have a neutral impact on the other relevant objectives. In addition to this, our view is that the Authority would be acting unlawfully if it directed that either of the Modification Proposals be implemented. Our reasoning is explained in the sections below.

(c) so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence

We believe that directing to implement either of these alternative proposals would have a detrimental impact on this relevant objective as it would put National Grid Gas plc (NGG)

¹⁵ Relevant objective d) is ‘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’.

¹⁶ Relevant objective g)) is ‘compliance with the Regulations and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.

¹⁷ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

¹⁸ Six out of eleven panel members recommended both modifications be implemented.

¹⁹ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.co.uk

²⁰ 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>

²¹ 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.

(ie. the licensee) in breach of the prescriptive rules of BAL. The licensee is required by its licence to establish transportation arrangements that are consistent with the achievement of the objective of (inter alia) '(g) compliance with the [Gas] Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators'²². BAL supplements the Gas Regulation and forms an integral part of it and references to the Gas Regulation are to be understood as also referring to BAL²³.

BAL clearly states that the TSO²⁴ must calculate imbalance charges for each gas day (ie. 05:00-05:00) and that those charges shall be paid to the TSO by network users that are out of balance²⁵.

The effect of either of the modification proposals would be that the TSO would calculate imbalance charges for a sub-set of Users (ie. those at a GMT Terminal) based on data for the 06:00-06:00 gas day instead of the 05:00-05:00 gas day. Further, by applying the imbalance charges incurred by those GMT Terminal Users across all Users (through the Neutrality Mechanism), the TSO would effectively be imposing some of the imbalance charges on parties that are not out of balance in that regard (ie. Users correctly balancing for the 05:00-05:00 gas day as per BAL). This would therefore be contrary to the specific requirements of BAL. We discuss this point more in detail in the section below on relevant objective (g) on compliance with EU law.

For these reasons we therefore consider that neither of these Modification Proposals would better facilitate the achievement of this relevant objective.

(d) so far as is consistent with sub-paragraphs (a) to (c) the 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

Most respondents and UNC Panel members agreed with both Proposers' view that implementing either of these modification proposals would restore equality for Users at GMT Terminals.

The Proposers state that due to insufficient relevant information about 05:00-05:00 gas flows at GMT Terminals before or during the gas day, Users at GMT Terminals are unable to control Time Shift Charges. As a result, they consider that they will always be at a greater risk of being out of balance at the end of the gas day. They therefore argue that they are being discriminated against and that there is a cross-subsidy (through the Neutrality Mechanism) between Users at these GMT terminals and those at non-GMT Terminals. The Proposers further assert that additional cross-subsidies are created by the new upstream allocation algorithm (ie. Option A) put in place by industry, due to the fact that the final 05:00-05:00 allocation for a User at a GMT Terminal is influenced by the gas flows by other Users at the same GMT Terminal.

Therefore, in the view of the Proposers, implementing either of the modification proposals would further relevant objective (d) as they claim that it would remove the alleged cross-

²² Gas Transporter Licence Standard Licence Condition A9 and Standard Special Condition A11

²³ As set out in BAL recital (8)

²⁴ As set out above, NGG is the TSO in this regard

²⁵ See provisions of Articles 19 – 23 BAL in particular Art.21(4) and Art.23(2).

subsidisation and discrimination that they consider is introduced as a result of the change in the definition of gas day in the UNC.

In contrast, NGG provided two representations²⁶ that disagreed with these assertions of the Proposers. NGG, amongst other things, stated that both modification proposals effectively require the socialisation of a proportion of a User's imbalance costs (which has been correctly calculated according to the UNC and BAL rules) to other Users via the Neutrality arrangements. They assert that this would have an adverse impact on competition between Users. Some of the UNC Panel members and the confidential response we received separately supported that view.

Although we recognise that the decision by most gas beach Terminal Operators to remain on a 06:00-06:00 gas day has created uncertainties on Users inputting gas into the NTS from these GMT terminals, we disagree with the Proposers' view that implementing one of these modifications would better facilitate the achievement of relevant objective (d).

We agree with NGG's view that implementing either of these modification proposals would be likely to have a negative impact on competition between Users. This is because we consider that the effect of both of the proposals would be to impose additional and unearned costs on parties that are duly balancing on a 05:00-05:00 gas day, including those that do not operate at any gas beach terminal. Such 05:00-05:00 Users are operating in accordance with the rules of the UNC and are equally liable to imbalance charges should they end the gas day out of balance. Should either of the proposals be implemented, these 05:00-05:00 Users would be effectively subsidising the costs of the Users at GMT Terminals by paying for some of their imbalance charges through the Neutrality Mechanism.

We also note that all UNC Users face a certain degree of uncertainty when forecasting their flows in and out of the NTS and we recognise that the risks and the available mitigating tools might be different for different Users (as described in the FMR). However, a fundamental principle of both the EU Gas Regulation and the pre-existing GB balancing rules is that each User is responsible for balancing their input and outputs. Allowing a sub-set of Users to essentially receive a "waiver" of some of their UNC charges, even if related to what are claimed to be "uncontrollable" circumstances, would be potentially discriminatory against all other Users that continue to do their best to accurately forecast their flows in and out of the NTS, yet are also subject to uncertainties that are caused by circumstances beyond their control.

Finally, as noted by both NGG and the confidential response, many entry points into the NTS (some gas beach terminals, interconnectors, LNG terminals) and all downstream industry parties have sustained costs to change the gas day and in some cases have chosen to do so even when not legally obliged by the ENCs (eg. in the case of the non-GMT terminals). Implementing either of these modification proposals would therefore be unfair towards those parties that have incurred costs in order to align with the UNC requirements relating to the timings of the gas day (and in particular the non-GMT Terminals who were not legally bound to do so).

For these reasons we therefore consider that neither of these Modification Proposals would better facilitate the achievement of this relevant objective.

²⁶ NGG provided an initial representation on 5 August 2015. This is reproduced in Appendix 1 of the FMR. They also responded to the Joint Office Consultation which closed on 11 April 2016. We have summarised their views as contained in both representations.

(f) so far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code

In their response to the industry consultation, NGG stated that in their opinion implementing either of these modification proposals would have a negative impact on relevant objective (f), as they would be required to re-calculate all Users' imbalance and neutrality positions from those initially calculated. Proposers and other respondents have not discussed this relevant objective.

We agree with NGG that having to recalculate imbalance and neutrality positions each time, whether before or after the invoicing, as proposed respectively by modification proposal UNC541A and UNC541B, could create inefficiencies in administering and implementing the UNC.

As we understand that the driver for these modification proposals is the lack of sufficient information flows between upstream producers and Users buying from them, we also agree with NGG that it might be more appropriate to find a solution to this issue that sits outside the UNC and does not introduce complexities and potential inefficiencies into a code that is a multi-lateral agreement between all downstream parties.

For these reasons we therefore consider that neither of these Modification Proposals is likely to better facilitate the achievement of this 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 set out above, BAL is a European Regulation that supplements the Gas Regulation and forms an integral part of it and references to the Gas Regulation are to be understood as also referring to BAL.

Articles 19, 21, 23 of BAL contain prescriptive rules on which parties should pay or receive imbalance charges, how the TSO should calculate a User's imbalance charges and how they should be applied. The following provisions in particular are of relevance:

- *Article 19(1) – Network users shall be bound to pay or be entitled to receive (as appropriate) daily imbalance charges in relation to their daily imbalance quantity for each gas day.*
- *Article 21(1) – The transmission system operator shall calculate a daily imbalance quantity for each network user's balancing portfolio for each gas day in accordance with the following formula:
Daily imbalance quantity = inputs – off-takes*
- *Article 21(3) – where the sum of a network user's inputs for the gas day is equal to the sum of its off-takes for this gas day, a network user is deemed imbalanced for this gas day and daily imbalance charges shall be applied in accordance with Article 23.*
- *Article 21(4) – Where the sum of a network's user's inputs for the gas day is not equal to the sum of its off-takes for this gas day, a network user is deemed imbalanced for this gas day and daily imbalance charges shall apply in accordance with Article 23.*

- *Article 23(2) – Daily imbalance charges shall be applied as follows:*
 - (a) *if a network user’s daily imbalance quantity for the gas day is positive then this network user shall be deemed to have sold gas to the transmission system operator equivalent to the daily imbalance quantity and therefore shall be entitled to receive a credit in respect of daily imbalance charges from the transmission system operator; and*
 - (b) *if a network user’s daily imbalance quantity for the gas day is negative then this network user shall be deemed to have purchased gas from the transmission system operator equivalent to the daily imbalance quantity and therefore shall be obliged to pay daily imbalance charges to the transmission system operator.*

BAL is therefore clear that the party that is out of balance is liable for the imbalance charge in respect of the amount for which they are out of balance. The assessment of the degree to which Users are in or out of balance is done for each gas day and from 1 October 2015 this gas day is the 24 hours period from 05:00-05:00 UTC. Both modification proposals propose an amendment of the imbalance calculation (or an adjustment by means of subsequent re-invoicing in the case of UNC541B) which essentially would mean that the imbalance quantity for a sub-set of Users (the GMT Users) is calculated using the data for a 06:00-06:00 gas day instead of the 05:00-05:00 gas day. This would clearly be in breach of the requirements of BAL.

Implementing either of the alternative proposals would also mean that the Users at a GMT Terminal do not have to pay the full imbalance charges in respect of the amount for which they are out of balance because the cost is smeared across all other Users as per the Neutrality Mechanism. So Users that may otherwise be in balance would effectively incur an imbalance charge and Users that are out of balance would not pay the full imbalance charge in respect of their imbalance quantity. This would again be contrary to the requirements of BAL.

At the UNC541A/B Workgroup on 6 October 2015²⁷ there was a lengthy debate on whether there was any form of hierarchy between the Gas Regulation and BAL, with some workgroup members believing the former was more important than the latter. Both Ofgem and DECC confirmed at the time that any proposal needs to comply with the requirements of both the Gas Regulation and BAL.

In this regard, we disagree with both Proposers’ view, as stated in the FMR, that there is a conflict between the Gas Regulation and BAL and that the present situation created by the change to the start and end time of the gas day puts GB in non-compliance with both the Gas Regulation and BAL.

We understand that the Proposers’ claim is that: i) the misalignment between the downstream and the upstream gas days has created a situation where Users at a GMT Terminal are not incentivised to balance (because they claim they have no control on forecasting accurately their 05:00-05:00 nominations for their flows at a GMT Terminal); and ii) charges imposed as a result of the imbalance are not cost reflective as the TSO is not in reality relying on nominations and is not likely to take imbalance actions as a result.

²⁷ The minutes of this meeting can be found on the Joint Office website here: <http://www.gasgovernance.co.uk/sites/default/files/Minutes%200541%2006%20Oct%2015%20v2.0%20Amended%20.pdf>

On the contrary, we consider that the present arrangements are compliant with both the Gas Regulation and with BAL. In terms of each of the two claims from the Proposers referred to above we have the following comments:

- (i) Disincentive to balance: Article 4(2) of BAL contains the general principle that users should be incentivised to balance their portfolios efficiently. The Gas Regulation Article 21(3) also states that imbalance charges should provide appropriate incentives on network users to balance their input and off-take of gas. We consider that the presence of imbalance charges provides a strong incentive on Users to balance such that both of these obligations are capable of being met.
- (ii) Cost reflectivity of charges: Article 19(3) of BAL states that '*the daily imbalance charges shall be cost reflective and shall take account of the prices associated with the transmission system operator's balancing actions, if any...*' Similarly, Article 21(3) of the Gas Regulation states that imbalance charges shall be cost-reflective to the extent possible. We note that the overall price methodology applied by NGG as TSO to calculate the imbalance charge (ie. cash-out prices) does take into account any balancing actions that NGG takes. Further, the requirement for cost-reflectivity relates to the amount of the imbalance charge being levied, whereas both of the Modification Proposals are about removing the levying of the imbalance charge in respect of the Time Shift Charges. If Users at a GMT Terminal are choosing to carry out their balancing behaviour based on the 06:00-06:00 gas day flows information, then they are potentially imposing costs on the system as their behaviour may not reflect the balance of the system for the 05:00-05:00 gas day, and NGG might need to take some balancing actions as a result of this. So, not applying imbalance charges to those that might have caused NGG to take balancing actions would make the arrangements less cost-reflective.

Further, Article 21(3) of the Gas Regulation prohibits cross-subsidiation between network users. If either of the Modification Proposals were to be implemented then we consider the net effect would be that all Users would be bearing the cost of the GMT Terminal Users being out of balance due to their choice to contract with GMT Terminals. We consider therefore that this could constitute cross-subsidisation by those non-GMT Terminal Users of those GMT Terminal Users.

Finally, we note that the Proposer of UNC541B claims that their modification proposal would be in compliance with BAL because the ex-post reconciliation uses the existing neutrality adjustment and this is consistent with the mechanism of reimbursement defined in Art.30(6) of BAL:

- *Where relevant the transmission system operator's methodology for the calculation of the neutrality charge for balancing may provide rules for the division of the neutrality charge for balancing components and the subsequent apportionment of the corresponding sums amongst the network users in order to reduce cross subsidies.*

As set out above, we consider that the Modification Proposals increase, rather than reduce, the risk of cross subsidies.

For the above reasons we believe that the present arrangements are compliant with the relevant EU Legislation and that implementing either of these modification would not better facilitate the achievement of this relevant objective.

Ofgem's powers and duties

Section 4C of the Gas Act 1986 specifically requires us to carry out our functions in the manner that we consider is best calculated to implement, or to ensure compliance with, any binding decision of the Agency for the Co-operation of Energy Regulators (ACER) or the Commission made under the Gas Directive, the Gas Regulation or the ACER Regulation in relation to gas. As set out above, CAM and BAL are European Regulations that supplement the Gas Regulation.

The Gas Directive requires NRAs to ensure that TSOs comply with their obligations under the Gas Directive and other relevant Community legislation²⁸. The Authority is the designated National Regulatory Authority (NRA) for GB²⁹ so we are obliged under EU law to ensure compliance by NGG, as a TSO, with its obligations under BAL.

As set out above, we consider that if either of the proposed Modifications were implemented NGG would be failing to fulfil its obligations under BAL in terms of its calculation and application of imbalance charges. Further, we consider that neither of the Modifications would ensure compliance with BAL or the Gas Regulation. Therefore, the Authority would be acting unlawfully if it directed that either of the Modification Proposals be implemented.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority has decided that modification proposals UNC 541A: 'Removal of uncontrollable UNC charges at ASEPs which include sub-terminals operating on a 06:00 to 06:00 Gas Day via setting charges which arise solely as a result of the different Gas Day timings to zero' and UNC 541B: 'Removal of uncontrollable UNC charges at ASEPs which include sub-terminals operating on a 06:00 to 06:00 Gas Day via ex-post adjustments to capacity, balancing, scheduling and INS charges' should not be made.

Frances Warburton
Partner, Energy Systems Integration

Signed on behalf of the Authority and authorised for that purpose

²⁸ Gas Directive 2009/73/EC Article 41(1)(b).

²⁹ In accordance with Section 3A of the Utilities Act 2000