

Representation – Modification

UNC 0728/A/B/C/D (Urgent)

Introduction of a Conditional Discount for Avoiding Inefficient Bypass of the NTS

0728	Introduction of a Conditional Discount for Avoiding Inefficient Bypass of the NTS
0728A	Introduction of Conditional Discounts for Avoiding Inefficient Bypass of the NTS
0728B	Introduction of Conditional Discount for Avoiding Inefficient Bypass of the NTS with 28km distance cap
0728C	Introduction of a Capacity Discount to Avoid Inefficient Bypass of the NTS
0728D	Introduction of Conditional Discounts for Avoiding Inefficient Bypass of the NTS

Responses invited by: 5pm on 26 June 2020

To: enquiries@gasgovernance.co.uk

Please note submission of your representation confirms your consent for publication/circulation.

Representative:	Bill Reed
Organisation:	RWE Supply & Trading GmbH
Date of Representation:	26 th June 2020
Support or oppose implementation?	<p>0728 - Support</p> <p>0728A - Support</p> <p>0728B - Support</p> <p>0728C - Support</p> <p>0728D - Support</p>
Expression of preference:	<p><i>If either 0728, 0728A, 0728B, 0728C or 0728D were to be implemented, which would be your preference?</i></p> <p>0728C</p>
Relevant Objective:	<p>0728:</p> <p>c) Positive</p> <p>d) Positive</p> <p>0728A:</p> <p>c) Positive</p>

d) Positive

0728B:

c) Positive

d) Positive

0728C:

c) Positive

d) Positive

0728D:

c) Positive

d) Positive

UNC0728, UNC0728A, UNC0728B, UNC0728C and UNC0728D also better meet UNC Objective (a) to the extent that they will prevent the construction of duplicate pipelines and the potential for stranding (or under-utilisation) of GB gas network assets.

**Relevant Charging
Methodology
Objectives:**

0728:
a) Positive
aa) Positive
b) Positive
c) Positive
e) Positive

0728A:
a) Positive
aa) Positive
b) Positive
c) Positive
e) Positive

0728B:
a) Positive
aa) Positive
b) Positive
c) Positive
e) Positive

0728C:
a) Positive
aa) Positive
b) Positive
c) Positive
e) Positive

0728D:
a) a) Positive
aa) Positive
b) Positive
c) Positive
e) Positive

Reason for support/opposition: Please summarise (in one paragraph) the key reason(s)

0728:

UNC0728 is better than the UNC baseline. It better facilitates competition and efficient operation of the GB gas network when compared with the baseline. It addresses the incentive created under the uniform capacity tariffs in the Reference Price Methodology (RPM) as a result of the implementation of UNC0678A (Postage Stamp) from 1st October for users to construct pipelines that will bypass the GB National Transmission System (NTS) where it is economic to do so. The proposal addresses the risk of bypass in a targeted, proportionate and compliant manner. UNC0728 introduces different treatment for certain users at eligible locations. This is justified discrimination since it will prevent the duplication of gas pipeline assets, reduces the risk of asset stranding (and under-utilisation), ensures market liquidity and competition at the Virtual Trading Point (VTP)

and thereby enhances cross border trade (when compared with the baseline). The resultant cross subsidies will result in a marginal change in the tariffs at other entry and exit points on the system the effects of which are mitigated by qualifying criteria including a distance limit, maximum and minimum discounts and a requirement for shippers to book and utilise firm capacity at the relevant entry and exit points. The proposal is compliant with Regulation 2017/460 establishing a network code on harmonised transmission tariff structures for gas (the TAR Network Code) and with Regulation 715/2009 on conditions for access to the natural gas transmission networks (the Gas regulation).

0728A

UNC0728A is better than the UNC baseline. It better facilitates competition and efficient operation of the GB gas network when compared with the baseline. It addresses the incentive created under the uniform capacity tariffs in the Reference Price Methodology (RPM) as a result of the implementation of UNC0678A (Postage Stamp) from 1st October for users to construct pipelines that will bypass the GB National Transmission System (NTS) where it is economic to do so. The proposal addresses the risk of bypass in a targeted, proportionate and compliant manner. UNC0728A introduces different treatment for certain users at eligible locations. This is justified discrimination since it will prevent the duplication of gas pipeline assets, reduces the risk of asset stranding (and under-utilisation), ensures market liquidity and competition at the Virtual Trading Point (VTP) and thereby enhances cross border trade (when compared with the baseline). The resultant cross subsidies will result in a marginal change in the tariffs at other entry and exit points on the system the effects of which are mitigated by qualifying criteria including a distance limit, maximum and minimum discounts and a requirement for shippers to book and utilise firm capacity at the relevant entry and exit points. The proposal is compliant with Regulation 2017/460 establishing a network code on harmonised transmission tariff structures for gas (the TAR Network Code) and with Regulation 715/2009 on conditions for access to the natural gas transmission networks (the Gas regulation).

0728B

UNC0728B is better than the UNC baseline. It better facilitates competition and efficient operation of the GB gas network when compared with the baseline. It addresses the incentive created under the uniform capacity tariffs in the Reference Price Methodology (RPM) as a result of the implementation of UNC0678A (Postage Stamp) from 1st October for users to construct pipelines that will bypass the GB National Transmission System (NTS) where it is economic to do so. The proposal addresses the risk of bypass in a targeted, proportionate and compliant manner. UNC0728B introduces different treatment for certain users at eligible locations. This is justified discrimination since it will prevent the duplication of gas pipeline assets, reduces the risk of asset stranding (and under-utilisation), ensures market liquidity and competition at the Virtual Trading Point (VTP) and thereby enhances cross border trade (when compared with the baseline). The resultant cross subsidies will result in a marginal change in the tariffs at other entry and exit points on the system the effects of which are mitigated by qualifying criteria including a distance limit, maximum and minimum discounts and a requirement for shippers to book and utilise firm capacity at the relevant entry and exit points. The proposal is compliant with Regulation 2017/460 establishing a network code on harmonised transmission tariff structures for gas (the TAR Network Code) and with Regulation 715/2009 on conditions for access to the natural gas transmission networks (the Gas regulation).

0728C

UNC0728C is better than the UNC baseline. It better facilitates competition and efficient operation of the GB gas network when compared with the baseline. It addresses the incentive created under the uniform capacity tariffs in the Reference Price Methodology (RPM) as a result of the implementation of UNC0678A (Postage Stamp) from 1st October for users to construct pipelines that will bypass the GB National Transmission System (NTS) where it is economic to do so. The proposal addresses the risk of bypass in a targeted, proportionate and compliant manner. UNC0728C introduces different treatment for certain users at eligible locations. This is justified discrimination since it will prevent the duplication of gas pipeline assets, reduces the risk of asset stranding (and under-utilisation), ensures market liquidity and competition at the Virtual Trading Point (VTP) and thereby enhances cross border trade (when compared with the baseline). The resultant cross subsidies will result in a marginal change in the tariffs at other entry and exit points on the system, the effects of which are mitigated by qualifying criteria including a distance limit, maximum and minimum discounts and a requirement for shippers to book firm capacity at the relevant entry and exit points. The proposal is compliant with Regulation 2017/460 establishing a network code on harmonised transmission tariff structures for gas (the TAR Network Code) and with Regulation 715/2009 on conditions for access to the natural gas transmission networks (the Gas regulation).

UNC0728C better meets compliance with the relevant legislation when compared with the original and the other alternatives since it does not require point to point bilateral arrangements and a requirement to flow which results in a commodity based Transmission Services charging. UNC0728C retains incentives to trade gas at the VTP with positive impact on market liquidity and competition at the VTP and it ensures efficient cross border trading when compared with the baseline, UNC0728 and the other alternatives.

0728D

UNC0728D is better than the UNC baseline. It better facilitates competition and efficient operation of the GB gas network when compared with the baseline. It addresses the incentive created under the uniform capacity tariffs in the Reference Price Methodology (RPM) as a result of the implementation of UNC0678A (Postage Stamp) from 1st October for users to construct pipelines that will bypass the GB National Transmission System (NTS) where it is economic to do so. The proposal addresses the risk of bypass in a targeted, proportionate and compliant manner. UNC0728D introduces different treatment for certain users at eligible locations. This is justified discrimination since it will prevent the duplication of gas pipeline assets, reduces the risk of asset stranding (and under-utilisation), ensures market liquidity and competition at the Virtual Trading Point (VTP) and thereby enhances cross border trade (when compared with the baseline). The resultant cross subsidies will result in a marginal change in the tariffs at other entry and exit points on the system the effects of which are mitigated by qualifying criteria including a standard distance limit (5km), a standard discount at all eligible locations and a requirement for shippers to book and utilise firm capacity at the relevant entry and exit points. The proposal is compliant with Regulation 2017/460 establishing a network code on harmonised transmission tariff structures for gas (the TAR Network Code) and with Regulation 715/2009 on conditions for access to the natural gas transmission networks (the Gas regulation).

Implementation: *What lead-time do you wish to see prior to implementation and why?*

UNC728, UNC728A, UNC728B, UNC728C and UNC 728D should be implemented with effect from 1st October 2020 or as soon as possible thereafter.

Impacts and Costs: *What analysis, development and ongoing costs would you face?*

UNC728, UNC728A, UNC728B, UNC728C and UNC 728D are based on the existing short haul administrative arrangements. We do not envisage any significant development or ongoing costs as a result of implementation.

The impacts of the proposed modifications on the level of cross subsidy were presented by NGG in a webinar on 24th June 2020.

Comparison of UNC 0728 Alternatives (published rates)

	0728	0728A	0728B	0728C	0728D
Contribution: TS Standard Rate	£138,636,371.20	£138,636,371.20	£168,633,107.34	£0.00	£123,344,370.09
Contribution: TS Discounted Rate	£19,196,277.79	£19,196,277.79	£45,604,218.22	£61,496,136.96	£9,650,299.94
Contribution: GNTS Standard Rate	£25,579,804.64	£0.00	£33,826,881.01	£25,579,804.64	£0.00
Contribution: GNTS Discounted Rate	£0.00	£5,115,960.93	£0.00	£0.00	£1,441,814.88
Potential TS Socialisation	£83,529,581.00	£83,529,581.00	£90,241,049.23	£181,129,324.23	£86,852,699.45
TS Socialisation as % of TO MAR	8.8%	8.8%	9.5%	19.1%	9.2%
GNTS Socialisation	£0.00	£20,463,843.71	£0.00	£0.00	£22,588,433.20
GNTS Socialisation as % of SO MAR	0.0%	9.6%	0.0%	0.0%	10.6%
Total Socialisation as % of Total MAR	7.2%	9.0%	7.8%	15.6%	9.4%
Routes Considered	17	17	22	18	15
Max Effective Rate Discount	72%	88%	72%	90%	91%

The values presented here are based on the published rates for Oct-2020. These are indicative values and should be taken as a means to better understand the sensitivities across each of the proposals, and not a view of the precise final charges in the event any of the modifications, when presented, are approved.

At the webinar NGG modelled the potential impact of existing contracts on the level of TS socialisation. This is illustrated below.

Existing Contract Scenarios

Below, the headline figures for all 0728 alternatives, all scenarios, across three separate years, are presented to provide an idea of the potential scale of impact on socialisation due to implementation of any one of the proposals.

2020/21	0728	0728A	0728B	0728C	0728D
Worst Case	£83,460,808.36	£107,469,923.24	£90,451,944.48	£186,862,717.23	£113,412,447.33
	7.2%	9.3%	7.8%	16.1%	9.8%
Scenario 1	£66,578,523.96	£90,587,638.84	£72,951,527.97	£121,675,546.50	£95,021,735.03
	5.7%	7.8%	6.3%	10.5%	8.2%
Scenario 2	£18,066,578.52	£42,075,693.40	£19,579,934.46	£39,167,035.16	£45,360,561.64
	1.6%	3.6%	1.7%	3.4%	3.9%
2025/26	0728	0728A	0728B	0728C	0728D
Worst Case	£44,576,782.12	£76,663,730.04	£48,310,778.44	£95,389,215.47	£81,801,403.13
	3.4%	5.9%	3.7%	7.3%	6.3%
Scenario 1	£44,576,782.12	£76,663,730.04	£48,310,778.44	£94,491,976.29	£81,801,403.13
	3.4%	5.9%	3.7%	7.2%	6.3%
Scenario 2	£20,925,000.04	£53,011,947.97	£22,579,437.81	£39,302,998.20	£57,685,813.95
	1.6%	4.1%	1.7%	3.0%	4.4%
2030/31	0728	0728A	0728B	0728C	0728D
Worst Case	£38,458,766.92	£71,892,020.35	£41,680,284.65	£82,213,699.06	£76,910,290.13
	2.7%	5.0%	2.9%	5.8%	5.4%
Scenario 1	£38,458,766.92	£71,892,020.35	£41,680,284.65	£82,213,699.06	£76,910,290.13
	2.7%	5.0%	2.9%	5.8%	5.4%
Scenario 2	£38,458,766.92	£71,892,020.35	£41,680,284.65	£57,310,220.43	£76,910,290.13
	2.7%	5.0%	2.9%	4.0%	5.4%

Scenario 1:

- The Shipper purchases entry capacity directly from NGG to obtain the 90% discount on eligible quantities and pays full price for any un-utilised capacity (under 0728A/B/D).
- If the EQ is lower than the level of Available New Capacity, Existing Contracts are not utilised.
- Only where the EQ exceeds the Available New Capacity are the Existing Contracts traded in to enable discount on the remainder of the EQ.

Scenario 2:

- The Shipper trades in entry capacity from the holder of the Existing Contract
- Existing Contracts are traded in up to the level of the EQ.
- Where the EQ exceeds the level of Existing Contracts, Available New Capacity is purchased to enable the discount on the remainder of the EQ.

The data presented by NGG illustrates the effect of UNC0728 and alternatives based on the historic pattern of firm capacity bookings and flows. We expect that these will be significantly different as a result of implementation of the UNC0678A (postage stamp) RPM.

The modelling does not reflect the impact of bilateral trading on gas prices at the VTP and the effect on cross border trade.

Legal Text: *Are you satisfied that the legal text will deliver the intent of the Solution?*

We do not have any comments on the legal text.

Respondents are requested to provide views on the following points:

Q1: Respondents are requested to provide a view as to whether the solution provided within the Modification(s) is fully compliant with the relevant legislation (including, but not limited to, Articles 28-32 of the Tariff Network Code).

Compliance with Relevant Legislation

UNC728, UNC728A, UNC728B, UNC728C and UNC 728D are fully compliant with the Tariff Network Code and the Gas Regulation. We have completed an assessment of compliance with relevant legislation and this included with our response (and should be read as part of our response).

With regard to compliance with Article 28-32 of the TAR Network Code we have the following observations (these are also included in our assessment of compliance with relevant legislation).

Compliance with Article 28 - 32

NGG has published the reference prices from 1st October 2020 under UNC0678A (Postage Stamp) in advance of the annual capacity auctions as required by the TAR Network Code. These do not take into account any discounts that may be available 1st October 2020 as a result of implementation of UNC0728 and any of its alternatives.

Market participants have been aware for some time that the issue of inefficient bypass of the NTS should be addressed alongside implementation of the new RPM under UNC0678A (Postage Stamp) either through the UNC0670R review group, the withdrawn modifications including UNC0718 and alternatives and through the NGG Gas Charging Discussion Document paper published on 28th April 2020 .

UNC0728 and alternatives have been published in advance of the annual capacity auctions and market participants can take a view on the impact of discounts on reserve prices and any future marginal adjustments to revenue recovery charges for the gas year commencing 1st October 2020.

There is sufficient time for implementation of UNC0728 or an alternative prior to the commencement of the new gas year on 1st October provided that an Ofgem decision is available to allow publication of the new revenue recovery charges prior to the start of the tariff period commencing on 1st October 2020 as required under the TAR Network Code. In any event UNC0728 or an alternative should be implemented as soon as possible.

Q2: Respondents are requested to provide views on the proposed implementation date(s).

UNC728 or UNC728A or UNC728B or UNC728C or UNC 728D should be implemented with effect from 1st October 2020 or as soon as possible thereafter.

Are there any errors or omissions in this Modification that you think should be taken into account? *Include details of any impacts/costs to your organisation that are directly related to this.*

We have not identified any errors or omission in the Modification and alternatives which we think should be taken into account.

Please provide below any additional analysis or information to support your representation

We have completed an assessment of compliance with the relevant legislation and this included below (and should be read as part of our response).

1. Introduction

- 1.1. This note provides a review of compliance with relevant legislation for UNC Modification proposals UNC 0728 and alternatives UNC0728A, UNC0728B, UNC0728C and UNC0728D¹. The modifications are proposing new arrangements to address the risk of users constructing pipelines that bypass the GB National Transmission System (NTS) as a result of the incentives created following the application of new capacity based tariffs to entry and exit points from 1st October 2020 under the Reference Price Methodology (RPM) introduced as a result of Ofgem approval of Modification UNC0678A (Postage Stamp) on 28th May 2020.
- 1.2. The note considers in particular compliance with Commission Regulation (EU) 2017/460 of 16 March 2017 establishing a network code on harmonised transmission tariff structures for gas² (the TAR Network Code) and with 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 1775/2005³ (the Gas Regulation).

2. Background

- 2.1. In their decision approving UNC0678A⁴ (the decision letter) Ofgem recognised the risk of NTS bypass. Ofgem stated the following: *“Preventing inefficient bypass of the NTS, in a targeted, proportionate and compliant manner is, in our view, desirable”* (page 3). Ofgem also stated that *“the construction or usage of alternative network infrastructure to the NTS which leads to higher costs overall would not represent an efficient outcome”* (page 3).
- 2.2. Ofgem noted in the decision letter that *“we also recognised that tariff arrangements must comply with the requirements of EU law (Article 7 of TAR NC and Article 13 of the Gas Regulation) for the avoidance of undue cross-subsidisation (§4.28.). Preventing inefficient bypass of the NTS is, in our view, desirable but this should be achieved in a targeted, proportionate and compliant manner”*.
- 2.3. Ofgem have committed to working with the industry and the Joint Office of Gas Transporters to facilitate the development and, depending on the assessment and approval process, timely consideration and where appropriate implementation of modification(s) that seeks to address inefficient bypass of the NTS.
- 2.4. National Grid Gas raised UNC0728 *“Introduction of a Conditional Discount for Avoiding Inefficient Bypass of the NTS”* on 9th June 2020. Four more alternatives proposals (UNC0728A/B/C/D) were submitted on the same day.
- 2.5. Modification UNC 0728 and alternatives UNC0728A, UNC0728B, UNC0728C and UNC0728D seek to introduce new discounted charging arrangements for using the NTS at certain entry and exit points. These discounts may reduce the risk of users constructing dedicated pipelines from entry points to exit points that would bypass the NTS.

¹ The Modification and Alternatives can be found at:

<https://www.gasgovernance.co.uk/0728>

² Commission Regulation (EU) 2017/460 can be found at:

<https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0460&from=EN%29>

³ Regulation 715/2009 can be found at:

<https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:211:0036:0054:en:PDF>

⁴ The Ofgem decision letter on UNC0678 and alternatives can be found at:

https://www.ofgem.gov.uk/system/files/docs/2020/05/unc678_-_decision_0.pdf

- 2.6. UNC0728 and alternatives share a number of key features⁵ that include for example a common application process and methodology for determining eligibility. The key differences between the proposals relate to the following:
- **The distance limit:** UNC0728, UNC0728A and UNC0728C the maximum distance of 18km is set with reference to the costs of building a pipeline and extent of cross subsidies. Under UNC0728B the distance is set at 28km reflecting the economic cut-off for the construction of a bypass pipeline. Under UNC0728D the distance is set at 5km;
 - **The nature of the discount:** UNC0728, UNC0728A, UNC0728B and UNC0728C introduce a discount that declines with distance. UNC0728D proposes a fixed 90% discount for all eligible routes;
 - **Linkage to flow or capacity:** UNC0728, UNC0728A and UNC0728B and UNC0728D relate the discount to the eligible shipper firm capacity and flow at entry and at exit for the eligible route. UNC0728C relates the discount to the shipper firm capacity at entry and exit for the eligible route; and
 - **Treatment of Non transmission Service charge:** UNC0728, UNC0728B and UNC0728C do not include a discount for non-transmission services charges. UNC0728A and UNC0728D include an 80% discount for non-transmission services charges
- 2.7. On 12 June 2020 Ofgem approved an urgent timetable for consideration of the UNC0728 proposals⁶ (the urgency decision). In this letter Ofgem requested that in order to facilitate consideration of compliance of this modification, including any proposed implementation date, with the relevant legislation (including but not limited to Articles 28-32 of the Tariff Network Code) the Joint Office of Gas Transporters should include a relevant question within the consultation response template, and expect parties to give this due consideration.
- 2.8. This note has been prepared as part of RWE's consultation response to the Joint Office with respect to the consideration of compliance with the relevant legislation and in particular the TAR Network Code (including Article 28-32).

3. Compliance with the TAR Network Code

- 3.1. The relevant provisions in relation to UNC0728 A/B/C/D and compliance with the TAR Network Code considered in this note are:

- i) Article 7 (a-e); and
- ii) Article s28 -32

Article 7 – “Choice of a reference price methodology”

- 3.2. Article 7 relates to the choice of a reference price methodology (RPM) and refers to compliance with Article 13 of the Gas Regulation. The aims of the RPM under Article 7 are:

*“(a) enabling network users to reproduce the calculation of reference prices and their accurate forecast;
(b) taking into account the actual costs incurred for the provision of transmission services considering the level of complexity of the transmission network;
(c) ensuring non-discrimination and prevent undue cross-subsidisation including by taking into account the cost allocation assessments set out in Article 5;
(d) ensuring that significant volume risk related particularly to transports across an entry-exit system is not assigned to final customers within that entry-exit system;
(e) ensuring that the resulting reference prices do not distort cross-border trade”.*

- 4.2. Each of the aims under Article 7 are considered in the following section.

⁵ The key features of these modifications are summarised in Appendix 1

⁶ The Ofgem Urgent Decision letter on UNC0728 and alternatives can be found at:
https://www.ofgem.gov.uk/system/files/docs/2020/06/unC0728_urgency_decision.pdf

Article 7(a) – enabling users to reproduce the calculation of reference prices and their accurate forecast

- 3.3. UNC0728 and alternatives are based on a transparent methodology. In the case of UNC0728, UNC0728A, UNC0728B and UNC0728C this methodology involves the calculation of a maximum distance limit which is related to the costs of constructing alternative pipeline infrastructure and the extent of any cross subsidy. UNC0728D introduces a 5km limit to define eligibility. In all cases they enable network users to reproduce the calculation of reference prices and their accurate forecast as is required under Article 7(a).

Article 7(b) - taking into account the actual costs incurred for the provision of transmission services

- 3.4. UNC0728 and alternatives are designed to reflect the costs of building alternative infrastructure that will bypass the NTS. The costs are based on estimates using the cost of building equivalent NTS infrastructure. To this extent they take into account the actual costs incurred for the provision of transmission services and the complexity of the network as required under Article 7(b). The proposals provide an incentive on Users to remain connected to the NTS in the form of a discount that reflects the avoidable cost.

Article 7 (c) - ensuring non-discrimination and prevent undue cross-subsidisation

- 3.5. This provision relates to both ensuring non-discrimination and preventing undue cross-subsidisation.
- 3.6. UNC0728 and alternatives introduce different treatment for certain users on the NTS by providing discounted entry and exit capacity charges where there is a credible risk for bypass of the NTS. These discounts will increase the capacity charge of all other users of the NTS.
- 3.7. The different treatment of users at eligible entry and exit points under UNC0728 and alternatives are justified as follows:
- **Bypass pipeline construction is feasible:** There is a credible risk that users will construct a bypass pipeline. This risk is quantified by an assessment of the costs of a user constructing a bypass pipeline to the NTS standard from an entry point to an exit point. For certain routes it is feasible (i.e. economic) for a user to construct a bypass pipeline based on the application of the relevant entry and exit capacity tariffs under the UNC0678A (Postage Stamp) RPM;
 - **Bypass pipelines lead to asset stranding (or under utilisation):** There is a credible risk that operation of duplicate pipelines will lead to stranding (under-utilisation) of certain regulated assets which is inefficient since all other customers will pick up the costs of the remaining network;
 - **Bypass pipelines may lead to inefficient operation of the GB gas network:** There is a credible risk that duplicate gas networks may impact on operation of the GB gas network for example through the impact on gas compression and network storage (e.g. linepack);
 - **Bypass pipelines will detrimentally impact market liquidity:** There is a credible risk that users who construct a bypass pipeline will reduce overall market liquidity through incentives to trade bilaterally and not to trade at the VTP (Virtual Trading Point). Once constructed the capital costs of a bypass pipeline will be a sunk cost. Users will have the option to flow gas to the exit point either from the entry point or the VTP (subject to any ongoing operating cost for the associated additional infrastructure and costs of maintaining the connection to the NTS and the exit capacity charges). Gas across a bypass pipeline will be less expensive than gas at the VTP to the extent of the avoidable NTS costs (entry and exit capacity charges); and
 - **Bypass pipelines will impact cross border trade:** There is a credible risk that bilateral trading across dedicated point to point bypass pipelines will impact on cross border trade through the resultant distortion of the GB gas price at the VTP. Note that
- 3.8. Discounted capacity prices at eligible entry and exit points results in a cross subsidy. Other users pay higher charges to ensure full recovery of the NTS costs. These extent of the cross subsidy is limited by the following elements that are included in the modification proposals:
- **Maximum distance limit:** This represents a straight line length of a notional bypass pipeline justified by the avoidable costs. This maximum distance is 18km for UNC0728, UNC0728A and UNC0728C, 28km for UNC0728B and 5km for UNC0728D:

- Maximum discount limit: This is set at of 90% at the minimum distance limit (0km):
 - Minimum discount limit: The minimum discount is set at 10% at the maximum distance limit. UNC0728D defines the minimum discount as 90% at 5km;
 - The discount is conditional on distance: The discount is a function of distance for UNC0728, UNC0728A, UNC0728B and UNC0728C. UNC0728D is based on a uniform 90% discount up to maximum discount limit of 5km;
 - Eligibility criteria: Shippers must apply for eligible routes and maintain firm entry and exit capacity across those routes; and
 - The arrangements are subject to review: NGG as gas transporter with review the maximum distance limit. This review can take into account the total amount of any justified cross subsidy.
- 3.9. UNC0728 and alternatives will result in efficient recovery of the costs of the GB regulated asset base when compared with the UNC0678A (Postage Stamp) baseline and prevent the duplication of gas pipeline assets. The proposals are based on due discrimination with cross subsidisation that is limited to the extent required to ensure effective competition and the efficient operation of the GB gas network.

Article 7 (d) ensuring that significant volume risk is not assigned to final customers

- 3.10. UNC0728, UNC0728A, UNC0728B and UNC0728D and alternatives are based on capacity discounts that are related to firm capacity bookings and the flow from the entry point to the exit point. The flows and the capacity bookings could be construed as a “volume risk” under Article 7(d).
- 3.11. UNC0728 and alternatives require adjustment to the revenue recovery charge to ensure efficient cost recovery from final customers . The extent to such adjustment is limited by the conditions associated with the product which ensures that the risk for other users is targeted and proportionate to ensure compliance. This should ensure that there is no “significant” (i.e. unlimited or uncapped) volume risk assigned to final customers as required under Article 7(d) (if the flow or capacity bookings were to be considered as a “volume risk” under Article 7(d)).
- 3.12. UNC0728C does not require flow from the entry point to the exit point in order to qualify for the discount and there is no flow based (volume) risk.

Article 7(e) - ensuring that the resulting reference prices do not distort cross-border trade

- 3.13. The absence of any discounts at locations where there is a credible risk of bypass under UNC0678A (Postage Stamp) reference prices creates incentives on users to construct duplicate pipeline infrastructure . The associated bilateral trading of gas as a result of this incentive will detrimentally impact liquidity at the VTP and distort cross border trade.
- 3.14. UNC0728, UNC0728A, UNC0728B and UNC0728D are better than the baseline with respect to ensuring that the resultant reference prices do not distort cross-border trade. UNC0728, UNC0728A, UNC0728B and UNC0728D ensure that users remain connected to the NTS. The requirement to flow from entry to exit will, however, influence trading at the VTP (through bilateral contracting), albeit at a level that is less of an impact compared to the UNC0678A baseline.
- 3.15. **UNC0728C is better than the baseline and UNC0728, UNC0728A, UNC0728B and UNC0728D in relation to ensuring that the resultant reference prices do not distort cross-border trade. UNC0728C does not include a requirement to flow and therefore has the least influence on trading at the VTP and would have limited impact on cross border trade.**

Article 7 – compliance overview

- 3.16. UNC0728, UNC0728A, UNC0728B, UNC0728C and UNC0728D are compliant with Article 7 in the TAR Network Code. Although the proposals introduce different treatment for certain users at eligible locations, this is justified discrimination since it will prevent the duplication of gas pipeline assets, reduces the risk of asset stranding (and under-utilisation), ensures market liquidity and competition at the Virtual Trading Point (VTP) and thereby enhances cross border trade (when compared with the baseline). The resultant cross subsidies

are mitigated by qualifying criteria including a distance limit, maximum and minimum discounts, and a requirement for shippers to book firm capacity at the relevant entry and exit points.

- 3.17. UNC0728C better meets compliance with TAR Network Code Article 7 when compared with the original and when compared with the other alternatives (UNC0728, UNC0728A, UNC0728B, and UNC0728D. This proposal removes the linkage to flow and does not require bilateral arrangements to flow gas from entry to exit. It ensures that the impact on competition and cross border flows is proportionate and appropriately targeted.

Article 28 - 32

- 3.18. Article 28-32 relate to the publication of information relevant to the setting of tariffs. In particular:

- Article 28: requires a consultation on discounts, multipliers and seasonal factors.
- Article 29 sets out the information to be published before the annual yearly capacity auction
- Article 30 sets out the information to be published before the tariff period
- Article 31 defines the form of publication
- Article 32 establishes the Publication notice period

Article 28 - consultation on discounts, multipliers and seasonal factors

- 3.19. Ofgem has consulted on implementation of UNC0678A (postage stamp) as required under the TAR Network Code under Article 28. This consultation did not include capacity discounts associated with potential changes to reflect inefficient bypass. However, the industry has been aware from some time that the issue of inefficient bypass will be addressed and this issue was highlighted in the Ofgem decision letter on UNC0678A.

Article 29 - the information to be published before the annual yearly capacity auction

- 3.20. NGG published relevant tariff information on reference prices for the GB RPM based on UNC0678A (postage stamp) as required under Article 29 (this is thirty days before the annual yearly capacity auction as required under Article 32 on 5th June 2020⁷.
- 3.21. The capacity prices published by NGG on 5th June do not reflect the impact of any capacity discounts or any revenue under recovery that could occur as a result of implementing UNC0728 or alternatives for the gas year commencing 1st October 2020. However, as noted above the industry has been aware from some time that the issue of inefficient bypass will be addressed and this issue was highlighted in the Ofgem decision letter on UNC0678A.
- 3.22. UNC0728 and alternatives have been raised in advance of the July 2020 annual capacity auctions. We would expect market participants to take into account the impact of UNC0728 and alternatives in this auction process.

Article 30 - information to be published before the tariff period

- 3.23. With regard to the publication of information linked to the reference prices that relate to the annual yearly capacity auction, it is important to consider the extent to which these prices can take into account the potential discounts associated with UNC0728 and alternatives at the time of publication, which is 5 months in advance of the gas year.
- 3.24. UNC728 and alternatives are linked to estimates of gas flow from entry and exit and firm capacity bookings (particularly in the case of UNC0728C). Only some of these capacity bookings would be annual capacity bookings given the incentives created by the application of postage stamp tariffs under UNC0678A. It may be difficult to estimate the impact of such variable discounts on reserve prices at the time that they are published ahead of the annual yearly capacity auction as required under Article 32.

⁷ The tariff information can be found at:

<https://www.nationalgrid.com/uk/gas-transmission/charging/transmission-system-charges>

- 3.25. In any event potential flows or booked within day firm capacity may be difficult to predict by the gas transporter with respect to the gas year commencing 1st October 2020 since this is the start of the new regime. Users will be developing their booking strategies in the light of the incentives created by the new capacity (postage stamp) tariffs under the RPM adopted as part of UNC0678A. It is difficult to determine the impact of these booking strategies on the annual capacity auction, and to determine whether UNC0728 or alternatives could have had any impact on the reserve prices published by NGG in advance of the annual yearly capacity auction for the gas year commencing on 1st October 2020.
- 3.26. Implementation of UNC0728 or alternatives for the gas year commencing 1st October 2020 may require within year marginal adjustments to revenue recovery charges that reflect the flow at eligible exit and entry points (as required under UNC0728, UNC0728A, UNC0728B and UNC0728D) or daily booked firm capacity (particularly under UNC0728C). The adjustments are required to ensure that the gas transporter recovers the required revenue.

Article 31 - the form of publication

- 3.27. The publication of tariff information by NGG ahead of the annual yearly capacity auction on 5th June complies with the form of publication as set out in Article 31. It is expected that tariff information with respect to the revenue recovery charge will be published later this year and in advance of the next gas year in compliance with Article 31.

Article 32 - the Publication notice period

- 3.28. Article 32 defines two key dates for the notification of tariff information. These are that tariff information set out in Article 29, including reference prices, must be published *“no later than thirty days prior to before the annual yearly capacity auction”* (Article 32(a)) and tariff information set out in Article 30 including revenue recovery prices is published *“no later than thirty days before the respective tariff period”* (Article 32(b)).
- 3.29. NGG published the relevant information with respect to the annual yearly capacity auctions for the gas year commencing 1st October 2020 on 5th June 2020 as required under Article 32(a).
- 3.30. NGG will publish the information required under Article 32(b) later this year. The information will include the target revenue to be recovered through network charges and under and over recovery allowances (Article 30 (1) (b) (vi) (1)). This means that the latest that the under and over recovery allowances can be published as a result of implementation of UNC0728 or an alternative is 31st August 2020.

Article 28-32 – compliance overview

- 3.31. NGG has published the reference prices from 1st October 2020 under UNC0678A (postage Stamp) in advance of the annual capacity auctions as required by the TAR Network Code. These do not take into account any discounts that may be available 1st October 2020 as a result of implementation of UNC0728 and any of its alternatives.
- 3.32. Market participants have been aware for some time that the issue of inefficient bypass of the NTS should be addressed alongside implementation of the new RPM under UNC0678A (Postage Stamp) either through the UNC0670R review group⁸, the withdrawn modifications including UNC0718 and alternatives and through the NGG Gas Charging Discussion Document paper published on 28th April 2020⁹. Note that in this document the impact of UNC0718C reflects the impact of UNC0728C with respect to extent of cross subsidies.
- 3.33. UNC0728 and alternatives have been published in advance of the annual capacity auctions and market participants can take a view on the impact of discounts on reserve prices and any future adjustments to revenue recovery charges for the gas year commencing 1st October 2020.

⁸ UNC0670R “Review of the charging methodology to avoid the inefficient bypass of the NTS” at <https://www.gasgovernance.co.uk/0670>

⁹ The Gas Charging Discussion Document and final report can be found at: <https://www.nationalgrid.com/uk/gas-transmission/charging/gas-charging-discussion-gcd-papers>

- 3.34. There is sufficient time for implementation of UNC0728 and alternatives prior to the commencement of the new gas year on 1st October provided that an Ofgem decision is available to allow publication of revenue recovery charges prior to the start of the tariff period commencing on 1st October 2020 as required under Article 32 of the TAR Network Code.

4. Compliance with the Gas Regulation

- 4.1. The relevant provision in relation to UNC0728 A/B/C/D and compliance with the Gas Regulation considered in this note is Article 13.
- 4.2. Article 13 (1) requires that the network tariffs that are subject to approval by the National Regulatory Authority (NA) *“shall be transparent, take into account the need for system integrity and its improvement and reflect the actual costs incurred, insofar as such costs correspond to those of an efficient and structurally comparable network operator and are transparent, whilst including an appropriate return on investments, and, where appropriate, taking account of the benchmarking of tariffs by the regulatory authorities”*. It also requires that the *“tariffs, or the methodologies used to calculate them, shall be applied in a non-discriminatory manner”*.
- 4.3. Article 13(1) also states that *“tariffs, or the methodologies used to calculate them, shall facilitate efficient gas trade and competition, while at the same time avoiding cross-subsidies between network users and providing incentives for investment and maintaining or creating interoperability for transmission networks”*. It requires that *“tariffs for network users shall be non-discriminatory and set separately for every entry point into or exit point out of the transmission system”*.
- 4.4. Article 13(1) also includes a specific provision that *“By 3 September 2011, the Member States shall ensure that, after a transitional period, network charges shall not be calculated on the basis of contract paths”*.
- 4.5. Article 13(2) 2. Requires that *“Tariffs for network access shall neither restrict market liquidity nor distort trade across borders of different transmission systems”*. It also requires that where differences in tariff structures or balancing mechanisms would hamper trade across transmission systems, transmission system operators and NRAs shall, *“actively pursue convergence of tariff structures and charging principles, including in relation to balancing”*.
- 4.6. Article 13 therefore includes a number of criteria which the NRA must take into account in approving of network charges. These include:
- The need to maintain system integrity and its improvement
 - Tariffs must be applied in a non-discriminatory manner
 - Facilitate efficient trade and competition
 - Avoid cross subsidies between network users
 - Incentives to ensure interoperability of gas networks
 - Tariffs for network users shall be non-discriminatory
 - Tariffs shall be set separately for every entry point into or exit points
 - Network charges shall not be calculated on the basis of contract paths
 - Tariffs for network access shall neither restrict market liquidity nor distort trade across borders
- 4.7. Each of these criteria is explored further in this note in relation to the GB RPM and UNC0728 and alternatives.
- i) **The need to maintain system integrity and its improvement:** The introduction of the UNC0678A (Postage Stamp) GB RPM from 1st October 2020 creates incentives for users to construct pipelines to bypass the NTS where it is economic to do so. This would result in duplication of pipeline infrastructure, lead to the stranding of existing GB network assets and increase the costs for all customers. UNC0728 and alternatives will maintain system integrity when compared with the

UNC0678A baseline since the discounts on offer will mitigate the risk of inefficient bypass and ensure that users remain connected to the GB NTS.

- ii) **Reflect the costs incurred by “efficient” TSOs:** UNC0678A (Postage Stamp) GB RPM is based on the efficient and uniform recovery of the costs of the GB NTS from all network users at entry and exit. UNC0728 will mitigate the risk of users constructing duplicate pipelines which would result in asset stranding, and inefficient cost recovery by the GB Gas Transporter. The discounts available reflect the credible risk of bypass and the savings that would be otherwise available to users if they were to construct their own pipelines. Therefore, the proposals take into account the costs that would be incurred by an efficient TSO in terms of asset stranding or under-utilisation of the GB gas network.
- iii) **Tariffs must be applied in a non-discriminatory manner:** UNC0678A (Postage Stamp) GB RPM will introduce capacity charges to both entry and exit. UNC0728 and alternatives will apply to both entry and exit points where there is a credible risk of bypass. The modification and alternatives are applied in non-discriminatory manner at all eligible locations. UNC0728 and alternative will result in the different treatment of certain users, but this discriminatory treatment is justified since without these arrangements there is a credible risk of inefficient bypass. The proposals have been designed in a targeted and proportionate manner that limits the extent of any cross subsidy.
- iv) **Facilitate efficient trade and competition:** Reference prices introduced under UNC0678A (Postage Stamp) GB RPM create incentives for users to construct pipelines to bypass the NTS where it is economic to do so. If users construct a bypass pipeline they will no longer transact at the VTP. This would be detrimental to efficient trade and competition. UNC0728 and alternatives create an incentive for users to remain connected to the NTS and to trade gas at the VTP. This will ensure that efficient trade and competition is maintained.
- v) **Avoid cross subsidies between network users:** The UNC0678A (Postage Stamp) GB RPM is applied at entry and exit in a manner that avoids cross subsidy and ensures efficient cost recovery. UNC0728 and alternatives will introduce different treatment of users through the application of a discount for certain users where there is a credible risk of the construction of a bypass pipeline (due discrimination). As a consequence there is cross subsidy between users which is justified on the basis that if the discounts were not applied then remaining users would face increased cost recovery associated with stranded assets (or under-utilised assets). The construction of duplicate pipelines would detrimentally impact on overall customer welfare (which would be greater than the impact of the cross subsidy).
- vi) **Incentives to ensure interoperability of gas networks:** No impact has been identified in relation to the interoperability of gas networks and the implementation of UNC0728 and alternatives.
- vii) **Tariffs for network users shall be non-discriminatory:** UNC0728 and alternatives will introduce different treatment of users at eligible entry and exit points. This different treatment is justified. In particular there is there is a credible risk that users will construct a bypass pipeline based on the incentives created by the GB RPM under UNC0678A (postage Stamp). Further, there is a credible risk that users who construct a bypass pipeline will reduce overall market liquidity through incentives to trade bilaterally and not to trade at the VTP. Finally there is a credible risk that bilateral trading across dedicated point to point bypass pipelines will lead to stranding (under-utilisation) of certain regulated assets which will, impact on overall GB security of supply and impact on cross border trade (at least through the distortion of the GB gas price).
- viii) **Tariffs shall be set separately for every entry point into or exit points:** The GB RPM under UNC0678A (postage Stamp) sets tariffs for each entry and exit point. UNC0728 and alternatives will introduce discounts under the RPM at certain entry and exit points where there is a credible risk of bypass which justifies differential treatment.

- ix) **Network charges shall not be calculated on the basis of contract paths:** The GB RPM under UNC0678A (postage Stamp) does not include contract paths. UNC0728, UNC0728A, UNC0728B and UNC0728D introduce capacity discounts that are conditional on flow from entry to exit (the point to point arrangement may be an implicit contract path). UNC0728C does not have any requirement to flow from entry to exit. Therefore there is no point to point arrangement under this proposal (implicit contract path).
- x) **Tariffs for network access shall neither restrict market liquidity nor distort trade across borders:** The RPM introduced under UNC0678A (postage Stamp) creates incentives for certain users to construct bypass pipelines through the application of uniform entry and exit capacity tariffs. In the absence on any discounts at locations where there is a credible risk of bypass, the construction of duplicate infrastructure will detrimentally impact liquidity at the VTP as a result of bilateral trading outside the VTP and distort cross border trade. With respect to the UNC0728 and alternatives the following observations can be made:
- UNC0728, UNC0728A, UNC0728B and UNC0728D ensure that users remain connected to the NTS. The requirement to flow from entry to exit will influence trading at the VTP (through bilateral contracting), albeit at a level that is less of an impact compared to the UNC0678A baseline.
 - UNC0728, UNC0728A, UNC0728B and UNC0728D are better than the baseline with respect to the impact on market liquidity and cross border trade.
 - UNC0728C, which does not include a requirement to flow, has the least influence on trading at the VTP and has limited influence on cross border trade.
 - **UNC0728C is better than the baseline and better then UNC0728, UNC0728A, UNC0728B and UNC0728D in relation to the impact on market liquidity and cross border trade.**

Gas Regulation Article 13 - Compliance Overview

- 4.8. UNC0728, UNC0728A, UNC0728B, UNC0728C and UNC0728D are fully compliant with Article 13 of the Gas Regulation. The proposals will prevent duplication of gas pipelines and asset stranding or under-utilisation. They maintain system integrity and ensure efficient operation of the gas network. The proposals introduce different treatment for certain users at eligible locations but, this fully justified and any cross subsidies are mitigated by qualifying criteria which limits the eligibility of the product. The proposals therefore enhance the overall welfare of GB gas network customers.
- 4.9. UNC0728, UNC0728A, UNC0728B, UNC0728C and UNC0728D better meets compliance with Gas Regulation Article 13 when compared with the baseline under UNC678A (postage stamp) with reference to market liquidity and cross border trade. The limited discount arrangements remove the incentive to construct bypass pipelines.
- 4.10. UNC0728C better meets compliance with Gas Regulation Article 13 when compared with the original and when compared with the other alternatives (UNC0728, UNC0728A, UNC0728B, and UNC0728D. This proposal removes the linkage to flow and does not require bilateral arrangements to flow gas from entry to exit. It ensures that the impact on competition and cross border flows is minimised under arrangements that are proportionate and appropriately targeted.

5. Conditionality in Contracts

- 5.1. In April 2019 ACER published a report on conditional contracts for standard capacity products for firm capacity in the EU gas market (The ACER Report)¹⁰ as required under the Network Code on Capacity allocation

¹⁰ "Report on the conditionalities stipulated in contracts for standard capacity products for firm capacity Fulfilling the requirement in Article 38(4) of the Network Code on Capacity allocation mechanisms in gas transmission systems", ACER, 5 April 2019 at:

mechanisms in gas transmission (CACM)¹¹. In the report ACER identified, amongst other findings, the following:

- i) Conditionalities exist when a network user is not allowed to book entry and exit capacities independently from one another, or faces restrictions on freely flowing gas from any entry to any exit point of a market area¹².
- ii) Conditionalities also exist when network users can choose not to use the freely allocable firm capacity and commit to a more restrictive contract in exchange for discounts. In this case, network users are incentivised by discounts to limit the use of freely allocable products in a given entry-exit system¹³.
- iii) Despite the differentiation used in the current terminology, the outcomes of conditionalities either imposed ex-ante in contracts, or chosen by network users in exchange for discounts, lead to similar outcomes¹⁴.

5.2. ACER described the existing arrangements in the GB market (in 2019) as one with services that affect “allocatability” of firm capacity¹⁵. According to ACER this means “services leading to modified allocability of a firm capacity product. Users can buy them as standard firm capacity product but could later transform them into a discounted product of a more limited use”¹⁶. ACER described the GB short haul product as follows:

- **“Shorthaul.**

Point-to-point service offered with a distance criterion set for the provision of the service, requiring linked entries and exits not to exceed a maximum distance. The user does not have access to the VTP [Virtual Trading Point]. In the UK, if the user pays the full price of the firm capacity, it can access the VTP”¹⁷.

5.3. ACER stated that “Conditional products and services have lower prices than the full firm, freely allocable capacity. The discounts vary depending on the product/service offered, and on the country”¹⁸. ACER went on to note in the same paragraph that “In the UK-Great Britain, the discount for shorthaul is given by a formula, where the discounted tariff increases with the distance and decreases with the capacity”.

5.4. ACER provided the following comments on conditional contracts:

- “As part of its obligations under the NC TAR, the Agency has reviewed several tariff methodologies. The Agency is aware that interactions between conditionalities and their tariff setting need to be further investigated, in particular the connection between the Reference Price Methodology (‘RPM’) and the application of conditionalities. This point directly connects to the necessity appropriately to understand the value of conditional products and propose a harmonised discount for them”¹⁹; and
- “The Study does not provide a clear-cut answer to whether conditionalities should be removed, instead promotes further country-based analysis”

https://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Publication/ACER%20Report%20on%20the%20conditionalities%20stipulated%20in%20contracts%20for%20standard%20capacity%20products%20for%20firm%20capacity.pdf#search=shorthaul

¹¹ Commission Regulation (EU) 2017/459 of 16 March 2017 establishing a network code on capacity allocation mechanisms in gas transmission systems and repealing Regulation (EU) No 984/2013. This can be found at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0459&from=EN>

¹² ACER Report, Paragraph 7

¹³ ACER Report, Paragraph 8

¹⁴ ACER Report, Paragraph 9

¹⁵ ACER Report, Figure 1

¹⁶ ACER Report, Paragraph 18

¹⁷ ACER Report, Paragraph 18

¹⁸ ACER Report, Paragraph 26

¹⁹ ACER Report Paragraph 28

- 5.5. ACER recommended further work on conditionalities particularly with respect to the effects on cross border trade in the context of the (CACM). ACER was particularly concerned whether the products could impact on marginal sources of gas, wholesale market (liquidity in particular), competition and security of supply.
- 5.6. In the context of the ACER Report the following observations can be made with respect to UNC0728 and alternatives:
- The proposals under UNC0728 and alternatives could be regarded as conditional contracts since a network user is not allowed to book entry and exit capacities independently from one another. UNC0728 and alternatives introduce “restrictions” on freely flowing gas from any entry to any exit point of a market area²⁰ either with respect to the flow from entry to exit (UNC0728, UNC0728A, UNC0728B and UNC782D) or with regard to the booking of firm capacity (particularly in relation to UNC0728C). The “restriction” is related to the qualification of an eligible route where there is a credible risk of bypass;
 - UNC0728 and alternatives do not restrict the use of firm capacity but the nature of the discounts may limit influence trading of gas to the VTP²¹; and
 - UNC0728 and alternatives may lead to modified allocability of a firm capacity product²². UNC0728 and alternatives will introduce arrangements where discounted entry and exit tariffs decrease with distance up to a maximum distance limit.
- 5.7. Based on the description of the existing GB short haul product in the ACER Report in paragraph 18 UNC0728 and alternatives have the following characteristics
- The product may be considered as a point-to-point services;
 - There is a distance criterion set for the provision of the service;
 - There is a requirement for linked entries and exits; and
 - The availability of the product is limited to a maximum distance limit.
- 5.8. With regard to access to the VTP [Virtual Trading Point] UNC0728, UNC0728A, UNC0728B and UNC0728D require that gas must flow from the entry point to the exit point in order to access the discount. This in effect requires a shipper to source gas at the entry point and flow the gas to the entry point. This transaction does not occur at the VTP (although it probably references the VTP price) and may impact on liquidity as there is an incentive on shippers (i.e. the discount) to avoid the VTP
- 5.9. UNC0728C has different characteristics to the other UNC0728 proposals. The discount will apply for entry and exit capacity for the eligible route and does not require a flow in order to qualify for the discount. Shippers can trade at the NBP without specific arrangements related to the flow of gas from the entry point to the exit point. Shippers will choose whether to flow gas at the entry point or exit point according to the price of gas at the VTP. This will facilitate competition and liquidity at the VTP.
- 5.10. ACER are particularly concerned in relation to CACM that offering discounted access to the gas network will reduce overall system integrity and impact cross border trade. In the case of UNC0728 and alternatives they key issue relate to the incentives to construct bypass pipelines as a result of the application of capacity based charges as required under the TAR Network Code. Bypass pipelines would impact network integrity by leading to the stranding of existing network assets and the duplication of pipelines, which will result in an inefficient solution for the GB gas network. The construction of bypass pipelines would also detrimentally impact on competition, particularly since the associated bilateral transactions would reduce liquidity at the VTP and distort cross border trade.

²⁰ See ACER Report paragraph 8.

²¹ This may result in to outcome identified in the ACER report in paragraph 9

²² As identified for the existing short haul product in GB in the ACER Report under paragraph 18

6. Conclusions

- 6.1. The RPM introduced under UNC0678A (postage Stamp) will be implemented from 1st October 2020. The uniform reference prices create incentives for certain users to construct bypass pipelines through the application of uniform entry and exit capacity tariffs. In the absence of any discounts at locations where there is a credible risk of bypass, the construction of duplicate infrastructure will lead to an inefficient GB gas network, detrimentally impact liquidity at the VTP as a result of bilateral trading outside the VTP and distort cross border trade.
- 6.2. UNC0728 and alternatives have been designed to take into account the credible risk of NTS bypass and a version should be implemented from 1st October 2020. They are based on an estimate of the avoidable costs of using the NTS and restrict the benefit to those users that may otherwise bypass the system through a maximum distance limit. The level of discount is appropriately designed such that it reduces the risk of bypass without providing additional subsidy beyond what is required.
- 6.3. UNC0728, UNC0728A, UNC0728B, UNC0728C and UNC0728D are fully compliant with the relevant legislation. The proposals will prevent duplication of gas pipelines and asset stranding or under-utilisation. They maintain system integrity and ensure efficient operation of the gas network. The proposals introduce different treatment for certain users at eligible locations but, this is fully justified and any cross subsidies are mitigated by qualifying criteria which limits the eligibility of the product. The proposals therefore enhance the overall welfare of GB gas network customers.
- 6.4. UNC0728, UNC0728A, UNC0728B and UNC0728D reduce overall market liquidity through incentives to trade bilaterally and not to trade at the VTP (Virtual Trading Point) when compared with UNC0728C since users are required to flow gas to the exit point in order to avoid NTS costs (entry and exit capacity charges).
- 6.5. **UNC0728C better meets compliance with Gas Regulation Article 13 when compared with the original and when compared with the other alternatives (UNC0728, UNC0728A, UNC0728B, and UNC0728D). This proposal removes the linkage to flow and does not require bilateral arrangements to flow gas from entry to exit. It ensures that the impact on competition and cross border flows is proportionate and appropriately targeted**

Appendix 1

UNC Modification Proposals 0728 and Alternatives: Comparison of Key Elements

Charge Group	Element	0728	0728A	0728B	0728C	0728D
		v1.0 (6/3/2020)	v1.0 (4/6/2020)	v1.0 (4/6/2020)	v1.0 (4/3/2020)	v1.0 (4/3/2020)
		National Grid	South Hook Gas Company	Mitol SA Geneva	RWE	ENI Trading & Shipping
Transmission Services Conditional Discount	Charge which the discount is applied to	Entry Capacity Reserve Price and Exit Capacity Reserve Price	Entry Capacity Reserve Price and Exit Capacity Reserve Price	Entry Capacity Reserve Price and Exit Capacity Reserve Price	Entry Capacity Reserve Price and Exit Capacity Reserve Price	Entry Capacity Reserve Price and Exit Capacity Reserve Price
	DCSL Distance (km)	18	18	28	18	5 (standard 90% discount)
	Initial Eligible Quantity (Entry)	(Lower of Entry Capacity, Exit Capacity, Entry Allocation, Exit Allocation) less any Existing Contract Capacity	(Lower of Entry Capacity, Exit Capacity, Entry Allocation, Exit Allocation) less any Existing Contract Capacity	(Lower of Entry Capacity, Exit Capacity, Entry Allocation, Exit Allocation) less any Existing Contract Capacity	(Lower of Entry Capacity, Exit Capacity) less any Existing Contract Capacity	(Lower of Entry Capacity, Exit Capacity, Entry Allocation, Exit Allocation) less any Existing Contract Capacity
	Initial Eligible Quantity (Exit)	Lower of Entry Capacity, Exit Capacity, Entry Allocation, Exit Allocation	Lower of Entry Capacity, Exit Capacity, Entry Allocation, Exit Allocation	Lower of Entry Capacity, Exit Capacity, Entry Allocation, Exit Allocation	Lower of Entry Capacity, Exit Capacity	Lower of Entry Capacity, Exit Capacity, Entry Allocation, Exit Allocation
Non-Transmission Services Conditional Discount	Charge which the discount is applied to	N/A	General Non-Transmission Services Charge	N/A	N/A	General Non-Transmission Services Charge
	Discount (%)	N/A	80	N/A	N/A	94
	Eligible Quantity	N/A	Lower of Entry Allocation, Exit Allocation	N/A	N/A	Lower of Entry Allocation, Exit Allocation
Variation in treatment of element from UNC Modification Proposal 0728						