

Modification proposal:	Uniform Network Code (UNC)716/A: Revision of Overrun Charge Multiplier		
Decision:	The Authority ¹ directs modification UNC716 be made ²		
Target audience:	UNC Panel, Parties to the UNC, Xoserve and other interested parties		
Date of publication:	18 September 2020	Implementation date:	1 October 2020

Background

One of the fundamental principles of the gas transmission capacity regime is the ‘ticket to ride’ principle, where shippers should acquire capacity rights to cover their flows of gas on and off the National Transmission System (NTS). Where a shipper flows gas in excess of its capacity rights, overrun charges will apply at NTS Entry and Exit Points. Overrun charges are intended to provide commercial incentives to purchase capacity before flowing gas and to ensure the costs of a participant overrunning are paid by that shipper.

NTS Entry Overrun Charges are applied to any user that flows more gas than the capacity they have booked.³ NTS Exit Overrun Charges are applied to flows above the aggregate capacity booked at specific Exit Points. Overrun charges are currently determined by a multiplier of eight applied to the bid or application prices already accepted for users acquiring capacity.⁴

The modification proposals

On 7 May 2020, National Grid Gas Transmission (NGGT) raised UNC716. The modification seeks to modify the current multiplier of eight used in the determination of overrun charges to three at NTS Entry Points, and six at NTS Exit Points. NGGT said that as a result of the changes initiated through UNC678A⁵ (Amendments to the Gas Transmission Charging Regime, Postage Stamp), capacity reserve prices will increase at some entry points and exit points, and decrease at others. Changes to capacity reserve prices impact application and bid prices for capacity bookings, which in turn affects the calculation of overrun charges. UNC678A will lead to a significant increase in average overrun charges. UNC716 seeks to reduce the multiplier used in calculating overrun charges at Entry and Exit points, to keep the incentive to book capacity at the level before UNC678A is implemented.

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 Revenue from NTS entry overrun charges currently feed into the Capacity Constraint Management incentive. In our RIIO-2 draft determinations we said that NTS entry overrun charges should be removed from the Capacity Constraint Management incentive. The consultation on our draft determinations closed on 4 September 2020. See the link to the draft determinations here: <https://www.ofgem.gov.uk/publications-and-updates/riio-2-draft-determinations-transmission-gas-distribution-and-electricity-system-operator>

⁴ Specifically, overrun charges are calculated as the amount of the overrun quantity multiplied by whichever is the greatest of the values mentioned in UNC TPD Section B, 2.12 and 3.13.

⁵ See our final decision on UNC678/A/B/C/D/E/F/G/H/I/J (28 May 2020) here: <https://www.ofgem.gov.uk/publications-and-updates/amendments-gas-transmission-charging-regime-decision-and-final-impact-assessment-unc678abcdefghij>

UNC716A was raised by Storengy as an alternative to UNC716. The proposer stated the aim was to reflect the objective of UNC705R ("Capacity Access Review"), by both reviewing the performance of the current overrun multiplier to reflect short-term changes in response to UNC678A, and to build what the proposer sees as a longer term overrun regime. UNC716A proposes to modify the multiplier to 1.1 in respect of overrun charges at both Entry and Exit Points.

UNC Panel⁶ recommendation

At the UNC Panel meeting on 16 July 2020, Panel Members expressed a preference for UNC716A but ultimately voted to recommend implementation of both modifications.⁷

Our decision

We have considered the issues raised by the modification proposals and the Final Modification Report (FMR), dated 17 July 2020. We have considered and taken into account the responses to the industry consultation on the modification proposal which are attached to the FMR⁸. We have concluded that:

- implementation of modification proposal UNC716 will better facilitate the achievement of the relevant objective (a) of the UNC;⁹
- directing that the UNC716 modification be made is consistent with our principal objective and statutory duties;¹⁰ and
- implementation of the UNC716 modification should take place on 1 October 2020, the start of the gas year and the day when UNC678A is implemented.

Reasons for our decision

We have considered the impact of the modification proposals against the relevant objectives (a) and (d) of the UNC.

Relevant Objective (a) the efficient and economic operation of the pipe-line system to which this licence relates

It was recognised by a number of panel members, industry respondents and the proposers of UNC716 and UNC716A that both modifications aimed to maintain an incentive on users to avoid under-booking capacity while updating the multiplier to reflect changes to capacity charges arising from the implementation of UNC678A. It was stated this would enable National Grid to plan, operate and manage the NTS, thereby facilitating the efficient and economic operation of its pipe-line system.

We recognise that an overrun regime is required to maintain the integrity of the capacity booking system and the ticket to ride principle for users flowing gas on and off the NTS.

⁶ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

⁷ Panel Members voted with 8 votes in favour (out of a possible 13), and agreed to recommend implementation of Modification 0716. Panel Members voted with 10 votes in favour (out of a possible 14), and agreed to recommend implementation of Modification 0716A.

⁸ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.co.uk

⁹ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, available at: <https://epr.ofgem.gov.uk/Content/Documents/Standard%20Special%20Condition%20-%20PART%20A%20Consolidated%20-%20Current%20Version.pdf>

¹⁰ The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986 as amended.

UNC678A will, in general, increase capacity prices increasing the incentive on users not to over-book capacity. A corollary of this is a continuing incentive (overrun charges) on user to not under-book capacity. Data in the FMR shows the impact of UNC678A on firm reserve prices, and how the multipliers proposed under UNC716 would be applied. Respondents to the industry consultation noted the reserve prices have been updated since the publication of the FMR. However, the basic point remains the same: both modification proposals will see lower overrun charges compared to if neither modification is implemented.

There is a risk that, with the 10% discount for interruptible and off-peak products introduced in UNC678A, that an overrun multiplier of 1.1 as proposed in UNC716A will not provide a strong incentive to avoid under-booking capacity. One respondent to the industry consultation said that UNC716A lacked analysis of the interaction between booking interruptible capacity at a discounted rate, and an overrun multiplier of 1.1. In effect, a user could face very similar costs for under-booking interruptible capacity and overrunning, and booking a higher level of interruptible capacity to match actual flows. This could lead to systematic underbooking of capacity, which could impact NGGT's ability to operate the network and reduce the effectiveness of the scaleback tool available for NGGT to manage the network. UNC716, which proposes overrun multipliers of three on Entry, and six on Exit does not introduce this risk.

UNC716A, and some industry respondents in support of it, suggested that UNC678A will cause users to move away from 'bulk-buying' excess volumes of nominal or zero cost capacity products toward profiling of short-term capacity products to closely match anticipated flows. The proposer of UNC716A also said that a multiplier that was 'too high' will lead to overbooking of capacity, undermining the value of capacity booking information in operating the network. In our UNC678A letter, we concluded that the new reference price methodology (Postage Stamp), in combination with the introduction of floating payable prices and removal of firm capacity discounts, should remove the incentive to overbook capacity that the previous arrangements tended to produce and encourage users to make more efficient use of the network.¹¹ We also said that in the context of a meshed network largely operating below capacity with expected declining demand and product multipliers of 1.0, market participants (other than Gas Distribution Networks) would profile capacity bookings close to actual flows using short-term capacity products, thus minimising the costs associated with over-booking of capacity.¹² Conversely, the overrun regime incentivises users against under-booking capacity. UNC716A does not provide a strong incentive for users to avoid under-booking capacity, for the reasons set out above.

In UNC716, the proposer states that it does not know to what extent behaviour will change following the implementation of UNC678A. The basis of UNC716 is to maintain a similar level of total revenue from overrun charges as the current regime by adjusting the multipliers to avoid increasing (or decreasing) the incentive for under-booking. We do not think this is necessarily an appropriate basis for a long-term incentive to avoid under-booking, in particular as there is no experience of how booking behaviour will change under UNC678A. Even if under-booking did remain at the current level (which NGGT in the FMR say over the last 3 years is around 1,000 instances annually on entry and between 70-90 annually on exit) as a result of UNC716, that level is not necessarily optimal. However, we do think it is an improvement on the current multiplier which would lead to a significant increase in overrun charges for under-booking as a result of the implementation of UNC678A, with no rationale. It was not the intention of introducing

¹¹ UNC678/A/B/C/D/E/F/G/H/I/J Final Decision (28 May 2020), page 13

¹² UNC678/A/B/C/D/E/F/G/H/I/J Final Decision (28 May 2020), page 20

UNC678A to increase the strength of the overrun charge regime which is what will happen if the overrun regime does not change. We also think UNC716 is better than UNC716A as there is a risk UNC716A will not provide a strong incentive to avoid under-booking capacity.

We welcome UNC716's suggestion of a review of overruns following the experience of how UNC678A impacts user behaviour.¹³ Panel Members also noted there is likely to be another review required once capacity booking behaviour changes after UNC678A implementation in October 2020.

Overall, we consider that modification proposal UNC716 will better impact UNC relevant objective (a).

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

Panel members thought that *not* implementing either UNC716 or UNC716A, given the implementation of UNC678A, would be detrimental to competition. The current overrun multiplier of eight combined with UNC678A would see a significant increase in overrun charges from 1 October 2020. Panel members thought this could create an additional barrier to new market entrants, going against the principle of relevant objective (d) to maintain effective competition.

We think that overrun charges are unlikely to act as a barrier to entry as they are a cost that falls on Shippers that underbook capacity and there is no evidence to suggest new entrants are more likely to overrun. Figures from NGGT show that one shipper flowed over a fifth of the total volume of gas overran on entry, and one shipper flowed 85% of the total volume of gas overran on exit in 2019-20. Overrun charges may promote competition as they ensure that the costs imposed by a user overrunning are directed back to that user rather than recovered across all shippers including those that incur costs to ensure they accurately book capacity.

Some industry respondents and panel members believed UNC716A provided an incentive that was more proportionate to costs. However, overrun charges are intended to incentivise shippers to book capacity accurately, and as noted above, UNC716A may significantly reduce the incentive for users to avoid under-booking capacity.

Overall our view is that the impact of both UNC716 and UNC716A is neutral on this objective.

Our principal objective and statutory duties

We have considered the modification proposals in respect of our principal objective and statutory duties. UNC716A will lead to a weak incentive to avoid under-booking capacity, which would impact the efficient and economic operation of the network to the detriment of end consumers.

¹³ See Final Modification Report (FMR) UNC716/A page 17

Implementation date

We note that the FMR and industry consultation responses recognise that continuation of the current overrun multiplier could lead to excessive overrun charges when UNC678A is implemented. The majority of respondents requested that either modification proposal should be implemented at the same time as UNC678A, on 1 October 2020.

We agree that continuation of the existing overrun multiplier will, following implementation of UNC678A, lead to an increase in overrun charges that was not intended by the introduction of UNC678A and has not been justified. Therefore, we have decided that the implementation date for modification UNC716 shall be **1 October 2020**.

Xoserve has confirmed that system testing has been completed in preparation for implementing either modification.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporter licence, the Authority hereby directs that modification proposal UNC716: 'Revision of Overrun Charge Multiplier' be made, in accordance with the implementation date set out above.

David O'Neill
Head of Gas Systems

Signed on behalf of the Authority and authorised for that purpose