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**SUBJECT: WWA Opinion - UNC 0751 Capping price increases for Long Term Entry Capacity - Compliance with TAR and Retained EU Law**

**Introduction**

Modification Proposal UNC 0751 proposes that the price at which Quarterly NTS Entry Capacity (QSEC) is originally acquired should be subject to annual upwards only indexation in line with the Consumer Price Index (CPI). In the event of deflation resulting in the indexed price being lower than the original price, the original price would apply. As the movement of CPI is uncertain and without limit, the result is not, as the title of the Modification Proposal implies, a price cap on the Capacity Charges for long-term Entry Capacity bookings, but rather an indexed linked price, subject to an as-bid price floor.

Modification UNC 0678A - Amendments to Gas Charging Regime (Postage Stamp), which was implemented on 1 October 2020, introduced new arrangements for QSEC acquired on or after the “Tariff Regulation Effective Date”, 6 April 2017, the date on which *Commission Regulation (EU) 2017/460 of 16 March 2017 establishing a network code on harmonised transmission tariff structures for gas* (TAR) came into force. These arrangements expose Users with long term QSEC to unpredictable price changes for any years occurring after the Gas Year immediately following the annual auction in which the capacity was acquired. The payable price for that Entry Capacity is determined not by reference to the reference price for the year in which the capacity is acquired, but by reference to the reference price for the Gas Year in which the capacity is to be used, an approach known as the “prevailing price methodology”.

According to the Proposer of UNC 0751, as a result of the prevailing price methodology, “Users are unable to lock-in a price for Long Term Capacity, resulting in Users being exposed to unpredictable and variable future costs. This undermines the attractiveness of booking Long-Term Capacity and imposes unmanageable risks on developers of infrastructure projects who are required to acquire long term NTS delivery rights in order to secure project financing.” In short, the current mechanism for establishing the price payable for long term NTS Energy Capacity is inimical to new developments required to maintain security of supply. It is for this reason that a more predictable payable price, based on CPI indexation, has been proposed.

This opinion explains why the mechanism for calculating the price payable for QSEC proposed by UNC 0751 is compliant with TAR and other Retained EU law, save to the extent that it applies to Entry Capacity at Interconnection Points.

## Scope of TAR

Article 2 of TAR makes it clear that much of that Regulation does not apply to the majority of exit and entry points. Chapters III, V, VI and IX and Article 28 only apply to Interconnection Points and entry points from third countries, where the national regulatory authority takes a decision to apply Regulation (EU) 2017/459 (CAM) to such points. In its consultation, [Facilitating the implementation of aspects of the Capacity Allocation Mechanisms Network Code in Great Britain](#), Ofgem notes that CAM “may also apply to entry points from and exit points to third countries, subject to the decision of the relevant NRA. Ofgem’s view is that there are currently no such entry or exit points in GB where CAM would be applied.” The consultation has closed without any further decision being made. Consequently, as regards the GB system, the aforementioned provisions of TAR only apply to Interconnection Points.

As regards Entry Points other than Interconnection Points, only the following provisions of TAR apply:

- Chapter I – General Provisions;
- Chapter II – Reference Price Methodologies;
- Chapter IV – Reconciliation of Revenue;
- Chapter VII – Consultation Requirements (with the exception of Article 28 - Consultation on discounts, multipliers and seasonal factors);
- Chapter VIII – Publication Requirements (with the exception of Article 31(2) and (3), which relate to Interconnection Points only); and
- Chapter X – Final and Transitional Provisions.

As regards GB, the following provisions of TAR apply solely to Interconnection Points:

- Chapter III – Reserve Prices;
- Chapter V – Pricing of Bundled Capacity and Capacity at Virtual Interconnection Points;
- Chapter VI – Clearing Price and Payable Price; and
- Chapter IX – Incremental Capacity.

## Interconnection Points

Chapter VI contains the relevant provisions as regards the mechanism for determining the price payable for capacity at Interconnection Points, as opposed to the permissible methodologies for establishing reference prices on which the price payable is based. The clearing price for an auction must be determined in accordance with Article 23. Simply put, it is the reserve price plus the auction premium.

Article 25 permits two possible approaches determining the price payable for capacity at Interconnection Points. In the UK (where the transmission system operator functions under a non-price cap regime) a fixed price payable approach may be used, but only in the case of a project of common interest under Article 3 of Regulation (EU) No 347/2013 on guidelines for trans-European energy infrastructure or where an alternative allocation mechanism under Article 30 of CAM is used. Otherwise, a floating price payable approach must be used. Article 24 provides that under the floating price payable

approach, the price payable for capacity should be the reserve price for the capacity product plus the auction premium, as provided by Section Y2.1.4 of the UNC. Consequently, the approach to the payable price proposed by UNC 0751 is non-compliant with TAR insofar as it relates to Interconnection Points.

Articles 23, 24 and 25 in Chapter VI and the related definitions of “floating price payable” and “fixed price payable” only apply with respect to Interconnection Points, so nothing in these Articles requires the payable price with respect to other entry points to be determined in accordance with the floating price payable approach outlined in Article 24.

## **Reference Price Methodologies**

As the name suggests, Chapter II (Reference Price Methodologies) deals with reference price methodologies rather than the actual prices payable generated by reference to them. It deals solely with reference price methodology, defined as “the methodology applied to the part of the transmission services revenue to be recovered from capacity-based transmission tariffs with the aim of deriving reference prices”. Article 6 requires that such methodologies, approved by the national regulatory authority, are applied to all entry and exit points. Unremarkably, Article 6(2) provides that the reference price methodology is applied so as to provide a reference price, defined as “the price for a capacity product for firm capacity with a duration of one year, which is applicable at entry and exit points and which is used to set capacity-based transmission tariffs”. Chapter II, unlike Chapter VI, does not go on to provide for how that reference price should be used to generate a payable price.

## **Permissible Tariffs for Entry Points**

Leaving aside Article 9, which requires a discount of at least 50% to be applied to capacity-based transmission tariffs at entry points from and exit points to storage facilities and permits discounts for entry points from LNG facilities and infrastructure ending isolation, the only provisions of TAR that relate to the setting of tariffs for entry points other than interconnection points are in Chapter I, Article 4. Article 4(3) provides that capacity-based transmission tariffs shall be used for the recovery of transmission services revenue, with exceptions permitted in favour of commodity-based charges in respect of revenue recovery reconciliation and recovery of costs mainly attributable to actual gas flows. Article 4(2) simply provides that transmission tariffs may be set in a manner “as to take into account the conditions for firm capacity products”.

The conditions that apply to QSEC booked on a long term are evidently different to QSEC booked solely for the year ahead. The User benefits from certainty as to its capacity rights going forwards, though in contrast to those only booking capacity year ahead, it is required to pay for that capacity over the long term, whatever the price might prove to be. There is no protection against unexpected price rises as is the case under the Kooperationsvereinbarung der Netzbetreiber, discussed in the Modification Proposal, under which shippers in Germany are entitled to terminate capacity bookings where its price is increased by more than the German CPI. The distinction between the conditions that apply to QSEC booked over the long term and QSEC booked in the following year provide ample justification for taking a different approach to long-term entry capacity.

There is no requirement under TAR to apply the reserve price for subsequent years for standard entry points in the same way as for Interconnection Points where a floating price is payable.

As for the rest of TAR, there is nothing in Modification Proposal UNC 0751, insofar as it relates to entry points other than Interconnection Points, that is non-compliant. Indeed, in light of the adverse impact of the UNC's current approach to the price payable on developers' willingness to invest in new sources of supply, it is questionable whether the UNC, as it stands, is compliant with TAR and the Retained EU legislation from which it is derived. According to Article (1), TAR, rightly, shares with Regulation 715/2009 the objectives of contributing to market integration, promoting the interconnection between gas networks and, critically in this context, enhancing security of supply. Article 7 states that the reference price methodology should comply with Article 13 of Regulation 715/2009, which requires that tariffs, or 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. Although the methodology used as the basis for calculating tariffs for long-term capacity is compliant with Article 13 of Regulation 715/2009, it is questionable whether the same can be said for the manner in which the price payable for long term capacity at entry points is currently calculated. By contrast, in light of the conditions applicable to long term capacity bookings at entry points (other than Interconnection Points), the use of CPI indexation to adjust the price derived from use of the standard reference price methodology payable for such capacity undoubtedly complies with Article 13.

## **Conclusion**

Modification Proposal UNC 0751 is not compliant with TAR insofar as it relates to Interconnection Points. In all other respects it is compliant with TAR. Different conditions apply to year ahead and long-term capacity bookings. In the case of the GB system, where, broadly speaking, capacity is under-subscribed, CPI indexation is a proportionate and permissible method of increasing the price payable for long-term capacity. The stated aim of Regulation 715/2009, the superior legislation from which TAR derives its authority, include "setting non-discriminatory rules for access conditions to natural gas transmission systems taking into account the special characteristics of national and regional markets with a view to ensuring the proper functioning of the internal market in gas" (Article 1(a)). By improving incentives to investment in new sources of supply for the GB market and taking into account the special characteristics of the GB market and its need to maintain diversity of sources of supply and storage as the delivery capacity of existing facilities decline, it better realises the objectives of Regulation 715/2009, and hence TAR, than the status quo.