

UNC Modification	At what stage is this document in the process?
<h1>UNC 0765:</h1> <h2>New retrospective debit and credit charges to reflect changes to the treatment of Entry Capacity Revenue between October and December 2020</h2>	<div style="display: flex; flex-direction: column; gap: 5px;"> <div style="border: 1px solid green; background-color: #28a745; color: white; padding: 2px; display: flex; align-items: center; justify-content: center;"> <span style="background-color: white; color: green; border-radius: 50%; padding: 2px 5px; margin-right: 5px;">01</span> Modification         </div> <div style="border: 1px solid #17a2b8; background-color: #e0f2f1; padding: 2px; display: flex; align-items: center; justify-content: center;"> <span style="background-color: white; color: #17a2b8; border-radius: 50%; padding: 2px 5px; margin-right: 5px;">02</span> Workgroup Report         </div> <div style="border: 1px solid #c0392b; background-color: #fce4ec; padding: 2px; display: flex; align-items: center; justify-content: center;"> <span style="background-color: white; color: #c0392b; border-radius: 50%; padding: 2px 5px; margin-right: 5px;">03</span> Draft Modification Report         </div> <div style="border: 1px solid #f39c12; background-color: #fff9c4; padding: 2px; display: flex; align-items: center; justify-content: center;"> <span style="background-color: white; color: #f39c12; border-radius: 50%; padding: 2px 5px; margin-right: 5px;">04</span> Final Modification Report         </div> </div>
<p><b>Purpose of Modification:</b></p> <p>The purpose of the Modification is to create new debit and credit charges to reflect the removal of revenues recovered from daily interruptible and within-day Entry Capacity (obligated only) from Capacity Neutrality arrangements between 01 October 2020 and 31 December 2020 (inclusive), consistent with the prospective change introduced from 01 January 2021 by UNC Modification 0748.</p> <p>Following implementation of UNC Modification 0678A on 01 October 2020, inappropriately high cashflows were subject to the Capacity Neutrality Arrangements (c. £0.5m per day). This Proposal seeks to create a charge to reflect removal of daily interruptible and within-day Entry Capacity (obligated only) revenue from Capacity Neutrality, within the relevant period so that these cashflows contribute to recovery of National Grid NTS' Allowed Revenues rather than redistribution across Entry Users.</p>	
	<p>The Proposer recommends that this Modification should be:</p> <ul style="list-style-type: none"> <li>• Considered a material change and not subject to Self-Governance; and</li> <li>• Assessed by a Workgroup.</li> </ul> <p>This Modification will be presented by the Proposer to the Panel on 15 April 2021. The Panel will consider the Proposer's recommendation and determine the appropriate route.</p>
	<p><b>High Impact:</b></p> <p>All parties that hold NTS Entry Capacity and National Grid NTS</p>
	<p><b>Medium Impact:</b></p> <p>None</p>
	<p><b>Low Impact:</b></p> <p>None</p>

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Timetable		
<b>The Proposer recommends the following timetable:</b>		
Initial consideration by Workgroup	04 May 2021	
Workgroup Report presented to Panel	15 July 2021	 as above
Draft Modification Report issued for consultation	16 July 2021	
Consultation Close-out for representations	06 August 2021	 as above
Final Modification Report available for Panel	11 August 2021	Systems Provider: <b>Xoserve</b>
Modification Panel recommendation	19 August 2021	 <a href="mailto:UKLink@xoserve.com">UKLink@xoserve.com</a>
Final Modification Report issued to Ofgem	20 August 2021	Other: <b>Phil Lucas</b>
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## 1 Summary

### What

From 01 October 2020 until the implementation of UNC Modification 0748 - *Prospective Removal of Entry Capacity Revenue from Capacity Neutrality Arrangements* on 01 January 2021, National Grid observed a material increase in revenue levels (from specific Entry Capacity auction processes) that were redistributed to Entry Users via the Capacity Neutrality Arrangements. These arrangements historically<sup>1</sup> redistributed circa £100k per month to Users, however within this period 01 October 2020 to 31 December 2020, the redistribution increased to approximately £15m per month. Therefore, these revenues did not contribute towards the collection of National Grid NTS' Allowed Revenue.

These specific revenues - within day Daily NTS Entry Capacity (obligated only) and Daily Interruptible NTS Entry Capacity - were removed from Capacity Neutrality arrangements from 01 January 2021 through the implementation of UNC Modification 0748. As a consequence, such revenue now contributes to National Grid's Allowed Revenue collection. However, this did not address the material quantity of revenue redistributed to Entry Users *prior* to implementation of UNC Modification 0748 (i.e. 01 October 2020 to 31 December 2020).

### Why

In its decision letter for UNC Modification 0748<sup>2</sup> Ofgem concluded that the arrangements that provided for material amounts of capacity revenue to be redistributed to firm entry capacity holders were discriminatory, were not objectively justified and had unintended consequences with regards to the existing Capacity Neutrality arrangements. It further observed that this redistribution adversely impacted competition between Shippers and concluded that implementation of the change would stop these undue cross-subsidies.

The combination of the new charging regime and existing Capacity Neutrality arrangements that resulted in these undue cross-subsidies was in place for a three month period between October 2020 and December 2020. It led to an overall value of circa £47m being inappropriately redistributed back to Users via Capacity Neutrality. This was inappropriate as there are Users that received significant payments from this neutrality process who made little or no contribution to the neutrality mechanism (and vice-versa). This has effectively created windfall gains and losses for individual Users.

Whilst recognising that a retrospective change *in principle* is not desirable and is detrimental to overall confidence in the integrity of the market arrangements, in this case National Grid believes such concerns are outweighed by the adverse impacts on competition of the inappropriate revenue redistribution actioned in this period. It should be noted that the retrospective period concerned is relatively short in duration (3 months).

If no action is taken to address the issue, the inappropriate revenue redistribution highlighted above will not be resolved thereby retaining the identified detrimental impact on competition between Shippers.

### How

It is proposed that two additional 'transitional' debit and credit charges are levied to effectively recover and re-distribute the revenues received (and re-distributed by National Grid NTS) from within day Daily NTS Entry Capacity (obligated only) and Daily Interruptible NTS Entry Capacity charges from the Capacity Neutrality arrangements between 01 October 2020 and 31 December 2020 inclusive. This will rectify the defect identified

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<sup>1</sup> i.e. prior to 01 October 2020

<sup>2</sup> [Decision letter for UNC Modification 0748](#)

in the historic arrangements. For the avoidance of doubt this defect has now been prospectively addressed (from 01 January 2021) by the implementation of UNC Modification 0748.

Proposed transitional charges:

- The debit charge will recover from relevant Users part of the revenue which was distributed to them as a consequence of the Capacity Neutrality mechanism. These Users inadvertently received a payment arising from the treatment of that part of the Capacity Revenue Neutrality Charges associated with interruptible and within day obligated Entry capacity during the period October to December 2020;
- The credit charge will re-distribute the revenue collected via the transitional debit charges to all holders of Fully Adjusted Entry Capacity (except Existing Available Holding) over the period 01 February 2021 to 30 September 2021 (inclusive). Each relevant User will receive transitional credit charges proportional to their capacity holdings over that period.

For the avoidance of doubt, the total amount of revenue received by National Grid would not be affected by the implementation of this Proposal. The impacts of Implementation are limited to the redistribution of Capacity Revenues to Users on a more equitable and appropriate basis.

## 2 Governance

### Justification for Authority Direction

This Modification Proposal is recommended to be sent for Authority direction as it is likely to have a material effect on commercial activities relating to the shipping, transportation and supply of gas because, if implemented, it will result in the re-distribution of approximately c.£47m revenue (that was initially subject to Capacity Neutrality arrangements) from a retrospective period (i.e. between October and December 2020).

Recognising that retrospective change to the regime *in principle* is not desirable, in this case this principle must be balanced against the adverse impacts on competition of the revenue redistribution actioned in this period if this issue remains un-addressed. The decision as to whether such adverse impacts are sufficiently material to outweigh concerns regarding retrospective change justifies the proposed approach of seeking a decision from the Authority in respect of this Proposal.

### Requested Next Steps

This Modification should:

- be considered a material change and not subject to self-governance
- be assessed by a Workgroup for a period of 3 months.

## 3 Why Change?

### Capacity Neutrality Arrangements in place between October and December 2020

Between October and December 2020, the UNC TPD Section B2.13.2 detailed the 'Relevant Capacity Revenues' which were subject to the Capacity Neutrality mechanism as set out in B2.13.3 to B2.13.7. The UNC EID Section B11.5 added into Relevant Capacity Revenues certain revenues from the equivalent Entry Capacity at Interconnection Points.

Relevant Capacity Revenues for this period included amounts payable to National Grid NTS (before the implementation of UNC Modification 0748) by Users by way of Capacity Charges in respect of:

- Daily NTS Entry Capacity that is registered on the day (TPD Section B2.13.2(a)(i)(1));
- Daily Interruptible NTS Entry Capacity (TPD Section B2.13.2(a)(i)(2));
- any additional Firm NTS Entry Capacity made available in excess of Unsold NTS Entry Capacity (TPD Section B2.13.2(a)(i)(3));
- Monthly NTS Entry Capacity allocated by reason of the acceptance of a rolling monthly surrender offer (TPD Section B2.13.2(a)(i)(4)).
- NTS Entry Capacity allocated in any Interruptible Day-ahead Auction or Within-Day Auction (EID Section B11.5.1(a)(i)); and
- Interconnection Point Capacity comprising quantities subject to Surrender Offers or Withdrawal Offers (EID Section B11.5.1(a)(ii)).

The operation of the Capacity Neutrality arrangements meant that National Grid NTS was held cash neutral by the subsequent return of such revenues to Users of the NTS.

The original purpose of Capacity Neutrality was to ensure that National Grid NTS in no way benefited from any Constraint Management costs, and therefore retained its neutral position. For example, if a User breached its Capacity holding with its physical flows, the subsequent Overrun Charges would be smeared back as a credit across the User Community on a monthly basis and would be based upon how much Firm Capacity each User holds for that specific day.

In the event of a constraint on the NTS, Capacity that had been previously acquired at zero price may suddenly incur a premium and it was important that National Grid NTS in no way benefited financially from subsequent increased revenues in those circumstances. Therefore, revenues from short term Capacity were also captured within Capacity Neutrality. However, the implementation of UNC Modification 0678A from 01 October 2020 changed how reserve prices are determined, including for short term Capacity and this, allied to the likelihood of revenues associated with them, provides justification to review this aspect of Capacity Neutrality for the period 01 October 2020 to 31 December 2020 inclusive.

As a consequence, the revenue that National Grid was entitled to recover from the provision of Entry Capacity on the NTS had to be recovered from Users procurement of other Entry Capacity products (i.e. those that are not subject to the aforementioned Capacity Neutrality arrangements).

The implementation of UNC Modification 0748 removed the following from the list of Relevant Capacity Revenues from 01 January 2021:

- Daily NTS Entry Capacity. Note this does not include Non-obligated Daily NTS Entry Capacity;
- Daily Interruptible NTS Entry Capacity;
- NTS Entry Capacity allocated in any Interruptible Rolling Day-ahead Auction or Within-Day Auction. Note this does not include Non-obligated Daily NTS Entry Capacity.

## Recovery of National Grid's Allowed Revenue

National Grid NTS is permitted by its Licence to recover amounts equal to its Allowed Revenue for provision of Transportation services to Users of its network (the NTS). The NTS Charging Methodology (UNC TPD Section Y Part A) sets out the principles applied by National Grid NTS in the setting of Transportation Charge rates to enable recovery of its Allowed Revenue in each Formula Year.

The NTS Charging Methodology in place prior to October 2020 (*'the previous Methodology'*) facilitated recovery of National Grid NTS' Allowed Revenue principally from flow based 'commodity' charges and long-term capacity products. Indeed, the vast majority of short-term capacity was available at low or zero unit cost (i.e. Interruptible / Offpeak / Within Day Firm). The socialisation of such relatively low revenue values under the Capacity Neutrality mechanism therefore had no material impact on the recovery of National Grid's Allowed Revenue at that time.

UNC Modification 0678A introduced a new NTS Charging Methodology (*'the new Methodology'*) from 01 October 2020 in order to comply with the newly introduced EU Tariff Code. This change was also the consequence of a review of multiple elements of the charging framework for GB, which included assessment of the most suitable Reference Price Methodology for Capacity.

In order to comply with the EU Tariff Code, the new Methodology provides for a principally capacity-based charging regime through which National Grid NTS aims to recover the majority of its Allowed Revenue via capacity charges. Where in the Tariff Year (Gas Year) there is forecast to be a difference between Allowed Revenue and the aggregate amount expected to be collected from capacity charges, the new Methodology provides for an additional Transmission Services Revenue Recovery Charge (TSRRC) to be applied to reconcile the two values.

## Impacts of Capacity Neutrality Arrangements in place between October and December 2020

From 01 October 2020 National Grid observed a material increase in revenues (from specific Entry Capacity auction processes) that were redistributed to Entry Users via the Capacity Neutrality Arrangements. These arrangements saw increased revenues between 01 October 2020 and 31 December 2020 inclusive<sup>3</sup>, the redistribution of these specific costs and revenues across Entry Users totalling approximately £15m per month within this period, compared to circa £100k per month prior to this point (i.e. an increase by a factor of 150). Therefore, these revenues did not contribute towards the collection of National Grid NTS' Allowed Revenue.

This issue needs to be addressed as this revenue distribution via Capacity Neutrality for this period was not consistent with the objectives of the charging methodology as set out in Standard Special Condition A5(5) of the NTS Licence. Specifically, it was not consistent with relevant methodology objectives:

- b) *to take account of developments in the transportation business;* on the basis that the Capacity Neutrality arrangements in place between October and December 2020 were not fit for purpose as they did not take account the implications of the increased proportion of revenue subject to neutrality arrangements from October 2020; and
- c) *to facilitate effective competition between shippers;* on the basis that the revenue distributed as a consequence of the operation of the Capacity Neutrality arrangements between October and December 2020 did not effectively target costs to those Users that accrued the benefit of the procurement of capacity.

This revenue distribution was not consistent with the above objectives. Aggregate revenues from Users contributing to Capacity Neutrality were not redistributed to such Users in the equivalent proportions to which they were received. Specifically, the increased scale of the relevant revenues (as described in this proposal) flowing through Capacity Neutrality from October 2020 following implementation of UNC Modification 0678A. The Capacity Neutrality process is designed to collect costs and revenues and redistribute them and whilst there is never an even balance between what is 'paid in' and 'paid out' to individual Users, the size of revenues flowing through from October 2020 creates an unfair distribution across Users. (Note that this unfair distribution was corrected from January 2021 with the implementation of UNC Modification 0748).

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<sup>3</sup> Implementation of UNC Modification 0748 from 01 January 2020 removed a material proportion of these revenues from Capacity Neutrality Arrangements meaning these revenues contributed to National Grid NTS' Allowed Revenue from this point.

This is because Capacity Neutrality as an overall 'pot' is redistributed in the proportions of a User's Fully Adjusted Firm Available NTS Entry Capacity and this presents cases where some Users will receive far more out of this 'pot' than they contributed to it. Therefore, in summary there were distributional impacts on all Users as the method by which neutrality payments are returned to Users differs to the way any National Grid NTS revenue shortfall is recovered via TSRRCs.

By way of illustration to use two potential scenarios:

- A User may not have had Capacity secured by auction (i.e. by trading the capacity in, where the liability remains with the original holder) and therefore did not pay any Capacity Charges directly to National Grid NTS however this User will have received a proportion for the Capacity Neutrality redistribution;
- a User that only purchased Interruptible Capacity via an auction, however this User would have received no proportion of the Capacity Neutrality redistribution as the redistribution is based on the percentage of firm capacity held by a User.

Analysis of the distributional impacts will be presented to and discussed in the Workgroup discussions and included in a subsequent iteration of the Proposal.

## UNC Modification 0748 'Prospective Removal of Entry Capacity Revenue from Capacity Neutrality Arrangements'

National Grid raised UNC Modification 0748 to prospectively address the defect it had identified in the Capacity Neutrality arrangements and Ofgem directed the implementation of this Proposal with effect from 01 January 2021. In its decision letter, Ofgem concluded that the arrangements that provided for material amounts of interruptible capacity revenue to be redistributed to firm entry capacity holders (highlighting added):

- were discriminatory; Ofgem stated  
“...the proposed modification would end the current **discriminatory arrangements**, whereby holders of within day and daily interruptible entry capacity contribute significant sums to the Capacity Neutrality arrangements which are thereafter paid to holders of firm entry capacity.”
- were not objectively justified and were unintended consequences of the existing arrangements; Ofgem stated  
“...different users face very different costs for the same service of gas transmission. Some users are currently being paid to use the NTS, while others face very high costs. These differences are **not objectively justified** and are not based on informed commercial decisions but they are the **unintended consequence** of the Capacity Neutrality mechanism.”
- adversely impact competition between shippers; Ofgem stated  
“The current operation of the Capacity Neutrality arrangements...has **adverse consequences for competition**...[and] are unduly discriminatory.” “...continuation of the current arrangements would **maintain the distortive redistributive effects**...whereby one category of network users cross-subsidises another category of network users”

Ofgem concluded that implementation of the change in UNC Modification 0748 (to remove the stated charges from Capacity Neutrality) would stop these undue cross-subsidies. It stated:

“Removing these...would **stop these undue cross-subsidies**, which have an **adverse impact on shipper competition**, on a prospective basis.”

It also noted alignment with the specific EU Regulations (which, for the avoidance of doubt, have been incorporated in UK law in accordance with the provisions of the European Union (Withdrawal) Act 2018<sup>4</sup>). It stated:

*“...the principles of ... Regulation (EU) 2017/460 ... (“TAR NC”) do not envisage that charges for capacity will be treated other than as part of the allowed revenue. Article 3 explicitly states that transmission services revenue is one of the revenue components comprising ‘allowed revenue’. Therefore, treating interruptible and within day firm entry capacity as part of the allowed revenue is consistent with TAR NC”*

*“...Article 13...of Regulation (EC) No 715/2009 ... (“Gas Regulation”) states that tariffs shall be applied in a non-discriminatory manner, 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...also...that tariffs ... shall neither restrict market liquidity nor distort trade across borders...The proposed modification would further the legal requirements set out...above.”*

Given that the deficiencies in the market arrangements (as a consequence of the material increase in revenue subject to neutrality arrangements) recognised above were apparent from October 2020, such deficiencies equally apply to the arrangement in place between this point and 31 December 2020.

## The Case for Retrospective Application

The arrangements identified as resulting in undue cross-subsidies were in place for a three-month period between October 2020 and December 2020, resulting in an overall value of circa £47m being redistributed back to a number of Users. Due to the size of revenues from within day and interruptible entry capacity contributing to the Capacity Neutrality (when they should be contributing to collection of revenues thereby not requiring collection from other Users), this was inappropriate, as a number of Users that received significant payments from this neutrality process made little or no contribution to it (and vice-versa). Further, in some cases beneficiaries from these arrangements do not pay TSRRCs, the charges needed to collect the resulting revenue collection shortfall. This has effectively created windfall gains and losses for some Users as a consequence.

Historically, National Grid NTS has recognised that retrospective changes *in principle* are not desirable and that they are detrimental to overall confidence in the integrity of the market arrangements. However, in this case National Grid NTS believes such concerns are outweighed by the adverse impacts on competition of the revenue redistribution actioned in this period.

In this case, National Grid NTS notes that the retrospective period concerned is relatively short in duration (the 3 month period between October and December 2020).

## Ofgem View of UNC Changes that Have Retrospective Impacts

Ofgem’s [Guidance on Code Modification Urgency Criteria](#) (as published on Ofgem’s website) includes its views on the inclusion of changes that have retrospective effect in Urgent Modification Proposals. This narrative includes its wider views on UNC Modification Proposals that advocate retrospective change, stating “*it is our view that retrospective modifications should be avoided as they undermine market confidence... However,*

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<sup>4</sup> This legislation (as amended by the European Union (Withdrawal Agreement) Act 2020) incorporated EU law existing immediately prior to the Implementation Period completion day (i.e. 31 December 2020) into UK law. This included EU Regulations 2017/460 and 715/2009 as they stood as at this date.

*despite the general principle against retrospective rule changes, we believe that there may occasionally be exceptions that could give rise to the need for a modification which would have retrospective effect.”*

It further states “*it is appropriate to consider any retrospective modifications on a case by case basis...the need for a retrospective change could, for instance, include:*

- *... the fault or error ... was directly attributable to central arrangements;*
- *... could not have been reasonably foreseen; or*
- *where the possibility of a retrospective action had been clearly flagged to the participants in advance...”*

National Grid NTS first raised the existence of an issue it had identified with the Capacity Neutrality ‘central’ arrangements at the Transmission Workgroup on 05 November 2020. This noted the adverse impacts of the arrangements observed from October 2020 and highlighted the potential to seek retrospective change to address this. Further engagement was undertaken with industry via the subsequent Transmission Workgroups, the NTS Charging Methodology Forum (NTSCMF) and a number of subject specific webinars over the following months.

## Options Considered to Address the Identified Defect

The increase in Entry Capacity Revenue subject to Capacity Neutrality arrangements from 01 October 2020, and the consequential shortfall in National Grid collected Revenue, necessitated the utilisation of TSRRC charges to recover the projected Gas Year-end shortfall compared to Allowed Revenue. The unit rate of this shortfall recovery (‘TSRRC rate’) was reduced as a consequence of the implementation of UNC Modification 0748 from 01 January 2021 recognising that this change prospectively addressed the issue, thereby reducing the expected scale of the shortfall.

In respect of a solution for the period October 2020 to December 2020, as part of initial discussions with industry (referred to above), National Grid NTS tabled a draft solution which proposed recovery of the associated capacity revenues from the relevant Users for the period October 2020 to December 2020. In absence of any further arrangements this would have necessitated further reduction of the TSRRC rate on the basis that the projected revenue shortfall will have been recovered from the relevant Users as opposed to via the TSRRC.

However, the solution proposed:

- in response to feedback received and in line with Ofgem’s [open letter to National Grid NTS](#) dated 23 December 2020, provides for an alternative solution which does not necessitate further change to the TSRRC rate;
- provides for redistribution (via a new charge) of the relevant Entry Capacity revenue to those Users holding capacity that attracts the TSRRC charge in the period February 2021 to September 2021 (inclusive); and
- does not adjust any published Transportation Charge rates.

The net impact of these two elements meets the objective of addressing the previous inappropriate redistribution of the relevant revenues via Capacity Neutrality whilst avoiding further revision of the TSRRC rate.

## 4 Code Specific Matters

### Reference Documents

[UNC TPD Section B](#)

[UNC EID Section B](#)

[UNC TPD Section Y](#)

[UNC Modification 0678A](#)

[UNC Modification 0748](#)

## Knowledge/Skills

Knowledge of the treatment of capacity revenues and charging principles would be beneficial.

## 5 Solution

### Principle

It is proposed that a **Transitional Entry Adjustment Charge (TEAC)** is established to create charges which facilitates that between 01 October 2020 and 31 December 2020 (inclusive) ('the relevant period') the following sources of revenue relating to provision of Entry Capacity were not treated as Relevant Capacity Revenues and were not therefore subject to Capacity Neutrality:

- Daily NTS Entry Capacity. Note this does not include Non-obligated Daily NTS Entry Capacity;
- Daily Interruptible NTS Entry Capacity;
- NTS Entry Capacity allocated in any Interruptible Rolling Day-ahead Auction or Within-Day Auction. Note this does not include Non-obligated Daily NTS Entry Capacity.

It is proposed that the TEAC is invoiced and payable in accordance with UNC TPD Section S and is determined as follows:

- **Receipts: Debit TEAC**

Users that received payments from Capacity Neutrality which reflected redistribution of revenue from charges associated with provision of the above capacity types (in respect of the relevant period) will be required to pay to National Grid NTS the TEAC.

The Debit TEAC will be payable by Users over a period of three consecutive months from implementation (M1, M2 and M3). For each User, the amount it received from the revenue redistribution (referred to above) for the Billing Period of:

- October 2020, will be invoiced in month M1;
- November 2020, will be invoiced in month M2; and
- December 2020, will be invoiced in month M3.

- **Payments: Credit TEAC**

National Grid NTS will make Credit TEAC to Users that, in aggregate, are equal to the aggregate Debit TEAC payable by Users. Credit TEAC will be payable to Users over a period of the same three consecutive months from implementation (i.e. M1, M2 and M3).

The amount payable to each User for each month ( $TEAC_u$ ) will be determined on the basis of the following:

$$TEAC_u = TEACR_m \times \left( \frac{FAEC_u}{FAEC} \right)$$

where:

$TEACR_m$  means the aggregate of Debit TEAC payable by all Users as invoiced the relevant month;

- FAEC<sub>u</sub> means the aggregate of the relevant User's Fully Adjusted Entry Capacity (excluding Existing Available Holdings) for each day within the period 1<sup>st</sup> February 2021 to 30<sup>th</sup> September 2021 (inclusive); and
- AFAEC means the aggregate of all Users' Fully Adjusted Entry Capacity (excluding Existing Available Holdings) for each day within the period 1<sup>st</sup> February 2021 to 30<sup>th</sup> September 2021 (inclusive).

## 6 Impacts & Other Considerations

### Does this Modification impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

No such impacts have been identified.

### Consumer Impacts

There will potentially be an impact on different consumer groups (as different Users are impacted based on their individual positions) but the total Allowed Revenue (determined in line with National Grid's Licence) which is collected by National Grid NTS will not change in the event of implementation of this Proposal. This Proposal will essentially apportion Transportation costs to Users of the NTS in a way that National Grid believes is fairer, more proportionate and better aligned to the EU Tariff Code principles than the previous arrangements (in place from October to December 2020) deliver, with a greater proportion of Entry Capacity revenue (regardless of whether they are short or long terms products) contributing towards the collection of National Grid NTS' Allowed Revenue. The Proposal would align (in principle) the treatment of capacity revenue recovered over the relevant period with the arrangements in place from 01 January 2021, following the implementation of UNC Modification 0748.

This proposal makes no changes to any published Transportation charges. Fairness within Transportation charges should support filtering down ultimately to consumers. Any consumer-based impacts would necessitate a range of assumptions that would be too complex to make certain. Decisions related to how Transportation charges are impacting downstream from UNC arrangements are wholly in the gift or obligations of those charging them via their contractual relationships.

Whilst no UNC remedy can ensure that costs feed through accurately to end consumers, this proposal seeks to address the effects of the windfall that has arisen to some Users (via the payments to some Users of the Capacity Revenue Neutrality Charge) at the cost to other Users (via the inflated Entry TSRRRC that will be applied to Users during the February – September 2021 period) and restore fairness through the Transportation Charges. Thus, it seeks to address the obvious, and material, distortion that otherwise will occur between Users. Ultimately, the nature of how the Users' Transportation charge liability is charged downstream from UNC arrangements will depend on how Users and other market participants structure their respective contracts and associated service charges.

For those paying Entry TSRRRCs currently, where the impact of the £47m may have been factored in to their reciprocal charges, the redistribution they receive from an approved Modification, provides certainty to this amount, which can in turn be accommodated into their charges. This should provide some benefit, depending on the timing of how this is ultimately catered for, assuming it is passed on over time through the market.

## Cross Code Impacts

No cross-code impacts have been identified.

## EU Code Impacts

EU Tariff Code principles have been considered as part of this Proposal in respect of the stated purpose of the capacity Reference Price Methodology (“...the methodology applied to the part of the transmission services revenue to be recovered from capacity-based transmission tariffs”) and Revenue Recovery charges (“...levied for the purpose of managing revenue under- and over-recovery”).

As the deficiencies in the market arrangements date back to October 2020, the compliance aspects noted by Ofgem in its decision letter in respect of UNC Modification 0748 are also relevant to the arrangements that were in place between October and December 2020. Therefore, implementation of this Proposal would better align historical arrangements with the identified aspects of the two following Regulations:

“...the principles of ... Regulation (EU) 2017/460 ... (“TAR NC”) do not envisage that charges for capacity will be treated **other than as part of the allowed revenue**. Article 3 explicitly states that transmission services revenue is one of the revenue components comprising ‘allowed revenue’. Therefore, treating interruptible and within day firm entry capacity as part of the allowed revenue is **consistent with TAR NC**”

“...Article 13...of Regulation (EC) No 715/2009 ... (“Gas Regulation”) states that tariffs shall be applied in a **non-discriminatory manner**, 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**...also...that tariffs ... shall neither restrict market liquidity nor distort trade across borders...The proposed modification would **further the legal requirements** set out...above.”

## Central Systems Impacts

There will be impacts on Gemini and UK Link invoicing systems. These impacts are being assessed and might require the provision of a ROM.

## 7 Relevant Objectives

Impact of the modification on the Relevant Objectives:

Relevant Objective	Identified impact
a) Efficient and economic operation of the pipe-line system.	None
b) Coordinated, efficient and economic operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters.	None
c) Efficient discharge of the licensee's obligations.	Positive
d) 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.	Positive

e) Provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards... are satisfied as respects the availability of gas to their domestic customers.	None
f) Promotion of efficiency in the implementation and administration of the Code.	None
g) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.	Positive

Demonstration of how the Relevant Objectives are furthered:

**c) Efficient discharge of the licensee's obligations.**

Implementation of this Proposal would charge back most of the capacity neutrality payments between October and December 2020 and redistribute this amount across the specified basis in the solution of this Modification. This continues with the principles established under UNC Modification 0748 that the capacity neutrality payments without change were excessive, effectively driving up the charges for other Shippers. Through this proposal it would charge amounts that should have contributed towards the allowed revenue collection based on the principles established implementing UNC Modification 0678A and return monies more equitably. It avoids necessitating an alternative approach of recovering a material proportion of National Grid NTS' Allowed Revenue via adjusting any published charges (i.e. TSRRC (Entry) or Transmission Services Entry Capacity Reserve Prices).

**d) Securing of effective competition between relevant shippers;**

The proposed changes in this Modification are expected to address the aforementioned revenue re-distributional impacts thus costs will have been targeted at Users in a more appropriate and fair manner. This is more consistent with the principles of the Charging Methodology which was implemented on 01 October 2020, thereby enhancing effective competition.

**g) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.**

The proposed changes in this Modification will ensure that the revenue recovery arrangements in place between October and December 2020 better align with the EU Tariff Code (Regulation 2017/460 as a component of Retained EU Law) principles relating to the purposes of the Reference Price Methodology and the TSRRC. The revised arrangement will also better align with the requirements of the Gas Regulation (Regulation (EC) No 715/2009 as a component of Retained EU Law) regarding non-discriminatory arrangements and avoiding cross-subsidies.

Impact of the modification on the Relevant Charging Methodology Objectives:	
Relevant Objective	Identified impact
a) Save in so far as paragraphs (aa) or (d) apply, that compliance with the charging methodology results in charges which reflect the costs incurred by the licensee in its transportation business;	Positive
aa) That, in so far as prices in respect of transportation arrangements are established by auction, either: <ul style="list-style-type: none"> <li>(i) no reserve price is applied, or</li> <li>(ii) that reserve price is set at a level -               <ul style="list-style-type: none"> <li>(I) best calculated to promote efficiency and avoid undue preference in the supply of transportation services; and</li> <li>(II) best calculated to promote competition between gas suppliers and between gas shippers;</li> </ul> </li> </ul>	None
b) That, so far as is consistent with sub-paragraph (a), the charging methodology properly takes account of developments in the transportation business;	Positive
c) That, so far as is consistent with sub-paragraphs (a) and (b), compliance with the charging methodology facilitates effective competition between gas shippers and between gas suppliers; and	Positive
d) That the charging methodology reflects any alternative arrangements put in place in accordance with a determination made by the Secretary of State under paragraph 2A(a) of Standard Special Condition A27 (Disposal of Assets).	None
e) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.	None

Demonstration of how the Relevant Objectives are furthered:

**a) charges reflect the costs incurred by the licensee in its transportation business**

implementation of this Modification will adjust the revenue that has already been invoiced and distributed under the operation of the Capacity Neutrality arrangements prior to the implementation of UNC Modification 0748 as these arrangements did not enable National Grid to recover material amounts of revenue from the sale of capacity in its network.

**b) properly takes account of developments in the transportation business**

implementation of this Modification will effectively adjust the arrangements from the point at which increasing proportions of revenue being subject to neutrality arrangements was observed, this being 1 October 2020 up to 31 December 2020. On this basis, for this period the arrangements will have appropriately taken account of developments in the transportation business observed since 1 October 2020.

**c) facilitates effective competition between gas shippers and between gas suppliers**

implementation of this Modification will adjust the retrospective revenue distribution (as a consequence of the operation of the Capacity Neutrality arrangements) from 1 October 2020 up to 31 December 2020 as these arrangements did not effectively target cost incurred by National Grid with the capacity neutrality taking into account the capacity and capacity revenues, the capacity neutrality payments made and the impacts of in terms of recovery from adjusting other charges. Effective targeting of costs and charges is a necessary cornerstone of competition.

## 8 Implementation

No implementation timescales are proposed. However, implementation is requested as soon as practicable following an Authority direction to do so, noting that implementation is required to take effect from the first calendar day of a month.

On this basis, implementation is proposed to take effect from the later of:

- the first calendar day of the month following the date of the notice from the Authority directing the implementation of this Proposal ('M+1') subject to a minimum period between such dates of [x]\* [calendar]\* days. Where this period is less than [x]\* [calendar days]\*, implementation will take effect from the first calendar day of the second month following the date of the notice from the Authority directing the implementation of this Proposal ('M+2').
- 1<sup>st</sup> [October]\* 2021.

In respect of the TEAC, month 'M1' will be the [first] calendar month following the month of implementation.

*\* this timeline and approach will be confirmed during the Workgroup phase.*

## 9 Legal Text

### Text Commentary

To be provided following finalisation of the solution

### Text

To be provided following finalisation of the solution

## 10 Recommendations

### Proposer's Recommendation to Panel

Panel is asked to:

- Agree that Authority Direction should apply;
- Refer this proposal to a Workgroup for assessment for a period of three months.