UNC Final Modification Report	At what stage is this document in the process?

UNC 0751:

Capping Price Increases for Quarterly System Entry Capacity

01 Modification
02 Workgroup Report
03 Draft Modification Report
04 Final Modification Report

Purpose of Modification:

To introduce a cap on the maximum price payable for Long-Term Entry Capacity to ensure equitability in the charging treatment of Long-Term Capacity products and facilitate investment in gas supply facilities.

The Panel does not recommend implementation

High Impact:

N/A

Medium Impact:

Shippers entering gas into the National Transmission System (NTS), investors in gas supply facilities and National Grid NTS

Low Impact:

N/A

Contents

Timetable

Modification timetable:

Initial consideration by Workgroup	02 February 2021
Workgroup Report presented to Panel	20 May 2021
Draft Modification Report issued for consultation	20 May 2021
Consultation Close-out for representations	11 June 2021
Final Modification Report available for Panel	15 June 2021
Modification Panel decision	17 June 2021 *(to be considered at short notice)*

Any questions?

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1 Summary

What

This Modification proposes to introduce a cap on the price paid by holders of Quarterly System Entry Capacity (QSEC) at domestic entry points.

Why

Following the implementation of Modification 0678A - Amendments to Gas Charging Regime (Postage Stamp), on 01 October 2020, the cost of holding QSEC or Annual Capacity is no longer fixed at the price at which the capacity was acquired in the relevant auction, or assignment of capacity via a Planning and Advanced Reservation of Capacity Agreement (PARCA) (hereafter collectively termed Long-Term Capacity). Instead, the payable price is determined by reference to the capacity prices published by National Grid for the Gas Year during which the capacity is held. This is commonly referred to as the application of a “prevailing price methodology”.

This significant change in the charging arrangements means that 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.

The concept of price capping exists in the European Union (EU) with Germany permitting the hand-back of capacity where the price of the underlying capacity holding increases by more than the German Consumer Price Index (CPI). Although the process of handing back capacity is not proposed in this Modification it is notable that an EU gas market recognises the harm caused by unpredictable price inflation and has introduced measures to mitigate against it.

How

The payable price of Long-Term Capacity assigned capacity in the Gas Year in which it is held will be capped at the price at which the capacity was acquired, adjusted by CPI.

CPI Inflation = (Month cap prices published CPI/Month cap auction CPI)

Price cap = CPI Inflation * Cap price at allocation

For the avoidance of doubt, the solution will not apply at Interconnection Points (“IPs”) due to restrictions which apply to non-price cap regulatory regimes contained in EU Tariff Code Article 25.

2 Governance

Justification for Authority Direction

This Modification Proposal is recommended to be sent to the Authority for 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 is likely to have a material impact on the allocation of charges across NTS network Users.

Requested Next Steps

This Modification should:

- be considered a material change and not subject to Self-Governance
- be assessed by a Workgroup

3 Why Change?

Before the changes made to the NTS Charging Arrangements on 01 October 2020, following the implementation of Modification Proposal 0678A, a User was able to fix the price of Long-Term Capacity at the price at which it was assigned. Although, prices remain fixed for QSEC capacity qualifying for existing contract status (capacity acquired before 05 April 2017) all subsequent purchases are subject to floating prices. The price of this capacity is set in accordance with the capacity prices published by National Grid for the Gas Year during which the capacity is held by the User.

It is well understood that the combination of fixed and floating prices has resulted in a two-tier system with existing contracted capacity enjoying significant discounts to other capacity products. This has been exacerbated by the switch from a commodity-based revenue recovery charge, to one based on capacity holdings, as existing capacity is exempt from the application of this charge. More specifically, and in terms of QSEC capacity, there is a stark contrast in the treatment of capacity holdings of the same product depending on the timing of the acquisition.

The purchase of Long-Term Capacity is a fundamental step in infrastructure project development. Both for new gas supply projects (such as Liquefied Natural Gas (LNG) re-gas plants, storage facilities, onshore/offshore production fields), or expansion of existing projects, longer-term capacity must be secured to mitigate against system and market access risks, or even to ensure capacity is made available in the NTS via capital investment by National Grid (in the case of incremental capacity above the baseline quantity). The purchase of Long-Term Capacity is a necessary step in securing project investment capital.

Prior to the implementation of Modification Proposal 0678A, Users (and their investors) were able to acquire Long-Term Capacity on a fixed price basis, with additional transportation costs, commodity-based charges, only applied once projects were operational and in receipt of positive revenue streams (through the onward sale of services, or gas sales). Post implementation of Modification Proposal 0678A, the costs of holding Long-Term Capacity cannot be fixed as a result of the application of prevailing prices and the potential for a further capacity-based Revenue Recovery Charge.

There are a number of consequences to this change in the treatment of Long-Term Capacity:

- Infrastructure projects cannot reasonably manage NTS access risk, as mitigation costs are unpredictable and “unbankable”. This will suppress the appetite of investors to back infrastructure projects (new or existing) with more marginal projects (such as gas storage facility investment) at greater risk of failing to progress.
- While the dual system of pricing remains between existing and other contracted capacity there is an unfair competitive advantage in favour of Users who possess existing contracted capacity. On the basis that the products which have been acquired are the same, beyond the date on which they happened to be acquired, this appears to be discriminatory. Without some level of price protection for non-existing capacity, the preferential treatment given the existing capacity is extreme resulting in market distortions based purely on the configuration of the NTS charging methodology.
- Due to the potential huge cost burdens associated with holding Long-Term Capacity, Users will be driven towards the shorter-term capacity market. This will have the combined effect of increasing the unit cost of capacity, as allowed revenue will be spread across a reduced volume and diminishing investment signals in the NTS more widely.

Current arrangements in German market

In other EU markets, such as the German Gas market, specific provisions have been introduced to protect capacity holders against excessive increases in the underlying price of the capacity product. In such cases where prices increase beyond a prescribed level, the capacity holder is permitted to hand-back all or some of its capacity.

The relevant process is defined in the so called "Kooperationsvereinbarung der Netzbetreiber" (cooperation agreement of grid operators) which German Transmission System Operators / Distribution System Operators (TSOs/DSOs) must develop in order to ensure an efficient access to the gas grid

The "Kooperationsvereinbarung" (KoV) is developed by the grid operators and discussed with grid users.

Included in the KoV it is required that network operators offer entry and exit capacities which allow network access without defining a transaction-dependent transport path and which can be used and traded independently of each other (note that this common carriage approach is the same as that operated in the UNC).

They must develop common contractual standards for network access and, taking account of technical restrictions and economic reasonableness, must exploit all possibilities for cooperation with other network operators with the aim of minimising the number of networks or sub-networks and balance areas.

"In case of increased charges, Shipper shall be entitled to terminate the contract in writing in full or in part, depending on the amount of the capacity booking, with a notice period of 10 working days from the effective date of the change. There is no right of termination if the increase in charges of the transmission system operator is less than or equal to the percentage increase of the consumer price index (overall index) for Germany (CPI) published by the Federal Statistical Office. The rate of change of the annual average CPI over the previous year published by the Federal Statistical Office at the time of the announcement of the increase in charges is decisive in this respect."

4 Code Specific Matters

Reference Documents

UNC TPD Sections B and Y

EU Tariff Code (Regulation 2017/460)

https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32017R0460

UNC Modification Proposal 0678A Ofgem Decision

https://www.ofgem.gov.uk/publications-and-updates/amendments-gas-transmission-charging-regime-decision-and-final-impact-assessment-unc678abcdefghij

Knowledge/Skills

An understanding of Modification 0678A, UNC TPD Sections B and Y and the EU Tariff Code, Gas would be beneficial.

5 Solution

It is proposed that for all Long-Term Entry Capacity, baseline and incremental, booked at domestic entry points (non-Interconnection Points) after the 05 April 2017, should be subject to a price cap. IPs are excluded from as price capping of charges would be in contravention of EU TAR Articles 24 and 25 which requires that the characteristics of the GB market, in particular that it operates a non-price cap regulatory regime, require it to operate a “floating payable price” method at IP points. The price cap will be established each Gas Year, during which the capacity is held, by reference to the Consumer Price Index (CPI). Were the CPI calculation to result in a price cap lower than the price of the capacity at the time of assignment, then the price will be set at the price at the time of the assignment.

The price cap will be set as follows:

CPI Inflation = (Month cap prices published CPI/Month cap allocation CPI)

Price cap = CPI Inflation * Cap price allocation at allocation

Floor (minimum) price is the capacity price at the time of assignment.

<u>Example:</u>

QSEC allocated in March 2018 at 0.0532 p/kwh/d, with prices published in February 2018 for the period from 01 October 2019 to 30 September 2034. Prices for Gas Year 2020/21 published in June 2020

Since 01 October 2020, the price of capacity is 0.0717 p/kwh/d

Price cap for capacity relating to October 2020 would be calculated as follows:

Feb 2018 CPI = 104.9

October 2020 CPI = 109.1

109.1/104.9 = 1.040038 (to 6 dp)

Price Cap = 1.040038 * 0.0532 = 0.0553 p/kwh/d

In this example the floor price chargeable would have been 0.0532 p/kwh/d, but as the CPI calculation results in a higher, the actual price charged (price cap) would be 0.0553 p/kWh/d for October 2020 capacity.

6 Impacts & Other Considerations

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

The proposals in this Modification do not impact a Significant Code Review or major industry change project.

Consumer Impacts

Proposer’s view: The total amount of revenue to be collected by National Grid is not changed, therefore the impacts on consumers will be negligible.

Consumer Impact Assessment (Workgroup view)	
Criteria	**Extent of Impact**
Which Consumer groups are affected?	The indirect impacts will be felt by all consumers large and small.
What costs or benefits will pass through to them?	This Modification directly benefits those shippers who hold quarterly capacity outside of Existing Contracts. The aim is to encourage longer term bookings which should encourage investment in infrastructure projects. This in turn should benefit consumers and Security of Supply overall by further supporting improved physical supplies into the GB market. Once any new infrastructure projects come onstream these too should encourage further bookings on the NTS. National Grid NTS noted that charges not paid by those benefiting from this Modification will need to be paid by other parties, as the overall amount of Allowed Revenue will not change as a result of this Modification. The Proposer noted that the Modification should encourage longer term bookings which otherwise would have been made on a very short term basis, which in turn will result in increased revenues to the benefit of all other Users.
When will these costs/benefits impact upon consumers?	After implementation.
Are there any other Consumer Impacts?	None identified.

General Market Assumptions as at December 2016 *(to underpin the Costs analysis)*	
Number of Domestic consumers	*21 million*
Number of non-domestic consumers <73,200 kWh/annum	*500,000*
Number of consumers between 73,200 and 732,000 kWh/annum	*250,000*
Number of very large consumers >732,000 kWh/annum	*26,000*

Cross Code Impacts

None identified.

EU Code Impacts

EU Tariff Code compliance is considered as part of this Modification proposal and subsequently in the Legal Opinion prepared by WWA and submitted to the Workgroup. This legal opinion is published here: https://www.gasgovernance.co.uk/0751

Workgroup Impact Assessment

02 February 2021

At its January meeting, UNC Modification Panel asked Workgroup to look at **consequential impacts** of this Modification. Workgroup briefly explored how the impact of this Modification might be analysed.

Workgroup reviewed the Proposer's view of the impact of this Modification over the period 2021-2034, based purely on historical bookings. This analysis can be found here: https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2021-02/WWA-UNC0751analysisv0.2.pdf .

A key conclusion was:

- Price capping could result in revenue under-recoveries over the period of around £295m (ranging from £8m/year to £33m/year).

This means that the aforementioned under-recoveries will be addressed by increased capacity charges of equivalent sums to be paid by other Users.

National Grid were asked to verify these figures.

04 March 2021

National Grid presented its assumptions and the results of its analysis. The results broadly matched those presented by WWA at the 02 February Workgroup.

In terms of assessing any future impacts, National Grid summarised that as long as prices continue to fall as suggested by the indicative prices, there would be very little impact. The concern was that if prices did rise and people began to take advantage of this Modification, there could be a spiralling problem of a dwindling base over which to recover Allowed Revenue. However, it appears to be unlikely that this will happen at the moment.

As Existing Contracts drop off, prices would be likely to decrease.

The Proposer noted that this Modification includes a price floor.

A Workgroup Participant noted that the floor price is the price at which the capacity was originally procured. This was felt to be appropriate.

Another Workgroup Participant noted that the existence of the floor price might act as a deterrent.

The Proposer felt that the price certainty would outweigh any detriment associated with potentially higher prices paid at the time of availability.

Compliance

02 March 2021

Workgroup Participants discussed the legal compliance document written and presented to Workgroup on 02 March 2021 by P Brennan (WWA).

A Workgroup Participant expressed concern that the Proposal might be non-compliant with TAR NC. He suggested that the reference price definition in EU Tar sets the payable price for all annual Entry and Exit products other than those where specific and explicit adjustments are permitted. He also cited the framework guideline definition which he felt was clearer and indicates the policy decision included in TAR NC and which was unamended through the TAR NC development process.

The view expressed by the Workgroup Participant was that according to TAR NC, prices should be fully floating. His understanding was that the framework guideline should apply to the definition in TAR NC itself. This Workgroup Participant highlighted to Workgroup the two definitions:

Reference price definition (ACER Framework Guideline 29 November 2013, Para 1.31)

The value of the annual capacity product for each entry and exit point calculated after the application of the cost allocation methodology. Where auctions are used, the reference price is used as the reserve price for the annual capacity product and the basis for setting the reserve prices for capacity products of shorter duration and for interruptible capacity. Where auctions are not used to allocate capacity the reference price is used as the regulated price for the annual capacity product.

Reference price definition (Commission Regulation (EU) 2017/460, Article 32)

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.

In relation to the conclusion in P Brennan's legal compliance document regarding the treatment of Interconnection Points in the proposal as it stood (v1.0 11 January 2021), the Proposer said that the Modification would be amended[3] so that it no longer applies to Interconnection Points to ensure compliance with TAR NC, as set out in P Brennan's legal compliance view.

A Workgroup Participant expressed concern that this would lead to discrimination between domestic and Interconnection Points.

P Brennan agreed that changing the Modification to exclude Interconnection Points does give different treatment for how long term capacity at IPs and domestic points within the system, the reason for this is national and regional differences which need to be taken into account and are allowed under TAR NC.

A Workgroup Participant asked for clarification that at Interconnectors, capacity is bought at fixed prices, permitted at the IPs under TAR NC, as long as there exists a 'risk premium', which for Interconnector UK is currently set at zero (as a Merchant Operator). She requested that the group consider this situation and suggested that Interconnection Points should be included in the Modification. P Brennan voiced his concern that inclusion of IPs would not be compliant with TAR NC.

12 April 2021

Workgroup Participants reviewed the changes made to the Modification in v2.0 dated 18 March 2021 and confirmed that the Modification does not now apply to Interconnection Points.

Workgroup Participants noted that the legal opinion given by WWA's P Brennan considered that the Modification as drafted in v2.0 is compliant with TAR NC and Regulation 715/2009 (as retained in GB law).

Workgroup Participants considered the compliance or otherwise of this Modification and were not able to give a view on compliance with TAR NC.

There is currently no separate treatment in the Charging Methodology for IPs in relation to domestic points.

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[1]https://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Framework_Guidelines/Framework%20Guidelines/Framework%20Guidelines%20on%20Harmonised%20Gas%20Transmission%20Tariff%20Structures.pdf

[2] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0460&from=EN

[3] The final version of the Modification (v2.0) includes this disapplication of Interconnection Points.

A Workgroup Participant noted that there may be a potential issue with discrimination in that charges will be set differently for IPs and Non-IPs (this relates to Regulation 715/2009).

National Grid NTS confirmed that there is a similarity between this concept and the concept of "Interim Contracts" as suggested in Modification 0621. This Modification 0621 and its alternative Modifications were rejected by Ofgem; one of the reasons given was due to this concept of "Interim Contracts". (the Ofgem decision letter for Modification 0621 and its alternatives can be found here: https://www.gasgovernance.co.uk/0621).

The Proposer considered that the concept of Interim Contracts in Modification 0621 involved extending the definition within Art. 35 to incorporate those contracts struck after 06 April 2017. This Modification 0751 is not doing the same thing. It is instead exposing quarterly contracts to a price inflation and therefore Article 35 is not relevant for this Modification.

Central Systems Impacts

Proposer's view: There will be impacts on Gemini and UK Link invoicing systems, however the Proposer anticipates these to be minimal as the calculations can be performed independently.

On 12 April 2021 Workgroup reviewed the ROM XRN 5336 (which can be found here: https://www.gasgovernance.co.uk/0751/120421) and noted the following information:

Rough Order of Magnitude (ROM) Assessment *(XRN 5336)*	
Cost estimate from CDSP	£115-150,000
Insert Subheading here	12-14 weeks

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	None

respects the availability of gas to their domestic customers.	
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

Proposers' view of how the Relevant Objectives are furthered:

(c) Efficient discharge of the licensee's obligations

The dual system of existing contracts and "new" long-term bookings has been introduced in order to achieve compliance with Article 35 of the EU Tariff Code. As a result of the price protections afforded to existing contracts, these contracts are held at a significant discount to all subsequent long-term holdings.

This premium is exacerbated by the fact that holders of subsequent long-term bookings are subject to future price variability as the price of capacity is set in accordance with the price notified by National Grid for the Gas Year during which the capacity is held, noting that the products are the same beyond the date on which they were purchased.

By providing a degree of price predictability and certainty through the introduction of a price cap, this Modification proposal creates a more level playing field for holders of existing contracts and those holding or looking to buy new capacity. In doing so it better facilitates Standard Special Condition A6 of National Grid Gas' (NGG's) gas transporter's licence which requires it "to conduct its transportation business in the manner best calculated to secure that … no gas shipper or gas supplier … obtains any unfair commercial advantage including, in particular, any such advantage from a preferential or discriminatory arrangement"

(d) Securing of effective competition

Providing a degree of price protection for new long-term bookings which introduces a degree of equivalence between products which are the same with the exception of the date on which they were purchased. Unlike existing contracts, where prices are fixed, this modification proposal limits price increases to the rate of inflation (measured by CPI), recognising that Article 35 of the EU TAR makes special provisions for contracts entered into before 05 April 2017. Without change, the continuation of an unfettered dual system means that Users who book new Long-Term Capacity are at a competitive disadvantage to those holding existing contracts. This results in not only different NTS access costs for Users, but the added burden of future cost volatility. Both of these outcomes are detrimental to competition.

Finally, price stability and predictability will improve investment conditions. Investors in new or expansions to existing gas delivery facilities will be more inclined to invest capital where future costs are fixed and can be incorporated into risk models. Where new investment is forthcoming, this will result in expanding the sources of gas supplies to the UK market, thereby improving GB security of supply and enhancing 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.

Article 13 of the EU TAR requires with respect to Tariffs and the methodologies used to calculate them:

- they should be applied in a non-discriminatory manner;
- they should facilitate efficient gas trade and competition, while at the same time avoiding cross-subsidies between network users and providing incentives for investment; and

- they should neither restrict market liquidity nor distort trade across borders of different transmission systems.

In its review of the GB charging arrangements, in accordance with Article 27 of the EU TAR, The European Union Agency for the Cooperation of Energy Regulators (ACER) noted that "the dual regime that may arise out of the treatment of Existing Contracts could potentially be considered as discriminatory, since comparable capacities will face different tariff conditions."

Although it is understood that as a result of Article 35 capacity acquired before 5 April 2017 should qualify for some price protection, the result is that Long-Term Capacity acquired after this date is exposed to higher and variable charges. The lack of any form of limitation on price inflation for such capacity results in discriminatory treatment across Users of the same product, with the exception of the date on which it is purchased. This is inconsistent with Article 13 of the EU TAR and aligns with the view expressed by ACER.

It should be noted that the treatment of other capacity products, such as monthly or daily, is not as straightforward as these are essentially different products to those protected by existing contract status.

In terms of the cap removing an exposure to prevailing prices, the application of prevailing prices is not a requirement of the EU TAR.

Workgroup Participants view of how the Relevant Objectives are furthered:

c) Efficient discharge of the licensee's obligations.

Workgroup Participants noted the Modification proposes different treatment for a particular tranche of capacity. Workgroup Participants were unsure whether this Modification positively impacts Relevant Objective c) in relation to SSC A6.

(d) Securing of effective competition

Some Workgroup Participants believed that the potential for this Modification to inflate prices for other Users may act to the detriment of the market.

(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.

Some Workgroup Participants believed there may be compliance issues with this Modification. These are further explored earlier in this report in section 6.

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;	None
aa) That, in so far as prices in respect of transportation arrangements are established by auction, either: (i) no reserve price is applied, or (ii) that reserve price is set at a level - (I) best calculated to promote efficiency and avoid undue preference in the supply of transportation services; and (II) best calculated to promote competition between gas suppliers and between gas shippers;	None
b) That, so far as is consistent with sub-paragraph (a), the charging methodology properly takes account of developments in the transportation business;	None

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.	Positive

Proposer's view of how the Relevant Charging Objectives are furthered:

(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

The proposal limits the increase in costs related to the purchase of Long-Term Capacity to the level of inflation as measured by the CPI. This will ensure that holders of this capacity will make a contribution to National Grid's allowed revenue while not exposing them to unpredictable and unmanageable risks. The risks are exacerbated by the fact that capacity is purchased far in advance of use and given the nature of the product is booked on a flat basis for the duration of product e.g. quarterly capacity is acquired via QSEC auctions held in advance of the holding and must be booked at the same level for each day of the quarter period.

This differentiates long term products from those spanning shorter term timescales. In the latter case the price of capacity is known and can be bought to meet shorter term needs, therefore allowing Users to manage costs.

Competition between shippers is harnessed by ensuring they are able to gain access to the NTS on a more equitable basis and in particular not to disadvantage or discriminate against those Users which are compelled to acquire a particular product to, for example, obtain access to investment capital to underpin project development. Price capping will address the risk imbalance which exists between short and longer term capacity booking. In addition, it will address the market distortion between existing contracts and those holding or intending to buy "new capacity". There is no economic justification for differential pricing between these products where the rights are the same, but the cost of access (price of the products) is significantly different. The two-tier system results in market distortions which unreasonably direct costs onto holders of longer-term capacity. The level of cross-subsidy is most significantly experienced by Long-Term Capacity holders on the basis that they are unable to match bookings with flows.

(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.

See comments raised under Relevant Objectives (g). In terms of price capping, the EU TAR permits charges to be levied at different rates for different products. The calculation of reference prices as set out in Article 6 of the EU TAR requires that the same reference price methodology is applied to all entry and exit points. Nothing in this modification detracts from this requirement, instead it proposes that the charge payable for longer term products can be different to that applied for other products. Further the application of alternative multipliers and seasonal factors explicitly allows for different reference prices and reserve prices to be applied across different products.

Workgroup Participants view of how the Relevant Charging Objectives are furthered:

(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

Some Workgroup Participants believed that the potential for this Modification to inflate prices for other Users may act to the detriment of the market.

(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.

Some Workgroup Participants believed there may be compliance issues with this Modification. These are further explored earlier in this report in section 6.

8 Implementation

No implementation timescales are proposed. However, implementation should be as soon as possible after an Authority direction to do so.

9 Legal Text

Legal Text and Legal Text Commentary has been provided by National Grid and is published alongside this report here: https://www.gasgovernance.co.uk/0751. The Workgroup has considered the Legal Text and had no questions or comments to offer on the Legal Text drafting as at 12 April 2021. Workgroup noted a small typo which will be corrected by National Grid before the Panel meeting on 15 April 2021.

The Proposer and National Grid confirmed that the Legal Text meets the intent of the solution.

10 Consultation

Panel invited representations from interested parties on 20 May 2021. The summaries in the following table are provided for reference on a reasonable endeavours' basis only. It is recommended that all representations are read in full when considering this Report. Representations are published alongside this Final Modification Report.

Of the 6 representations received 3 supported implementation, and 3 were not in support.

Representations were received from the following parties:

Organisation	Response	Relevant Objectives	Key Points
ExxonMobil Gas Marketing Europe Limited	Support	d) - positive Charging: e) - positive	• Believes entry capacity costs are a major consideration for gas shippers, whether modelling an upstream development project, entering into long term gas sales and purchase contracts, or seeking shorter term optimisation opportunities through gas trading. Concerns include both the absolute level of the charge, and its stability/predictability over time. • Noted, this has always been the case in the UK,

			however the implementation of new charging arrangements in October 2020 has introduced three further complications. First, the absolute level of charges at some entry points has increased significantly from historic levels. Second, shippers are no longer able to secure long term capacity at a fixed or known price due to the move to a fully floating reserve price. And third, these challenges are further compounded by the level of capacity price volatility that has been evident since the new arrangements came into effect. • Believes this level of capacity price uncertainty means that gas shippers are likely to be much more circumspect about entering into new investments to bring gas into the UK market, and may face real challenges in securing funding with such a large unknown and un-hedgable cost risk. Where decisions are taken, these are likely to include a notable risk premium. In the longer term this is likely to lead to an unfavourable outcome for the UK market and gas consumers. • Believes Modification proposal 0751 introduces a pragmatic solution by which shippers can secure long term entry capacity, potentially across multiple years, indexed to a pricing mechanism which is much more stable than that provided by the current postage stamp charging mechanism. This will help mitigate many of the challenges outlined above. • Proposes implementation should be as soon as possible. • With regards to impacts and costs noted that to the extent that this modification limits prices increases for long term capacity holders compared to prevailing stamp reserve prices, an increase in those postage stamp price levels is to be expected in order to maintain National Grid's allowed revenue recovery. • Is satisfied that the legal text will deliver the intent of the solution. **Answer to Panel Questions:** • Q1: Provide views on whether this Modification is suitable for Self-Governance procedures. ○ ExxonMobil's preference is for this Modification to be implemented as soon as possible; to that end Exxon Mobil would prefer that Self-Governance procedures were followed. However, there are aspects of this Modification that ExxonMobil believe lean more towards Authority direction. These include impacts on capacity prices for those

			benefitting under this proposal; potential impacts upon reserve prices for those not caught by this proposal; questions around compliance which the Workgroup was unable to conclude; and previous Ofgem principles/decisions which this Modification may impinge upon (e.g. Interim Contracts, and the right to hand-back capacity to National Grid in the event of a significant price increase). • Q2: Provide views on whether there are any compliance issues associated with this Modification. o Potential TAR NC compliance,
National Grid Gas	Oppose	c) None d) Negative g) Negative Charging: c) Negative e) Negative	• Notes the Modification proposes a price cap on Quarterly System Entry Capacity (QSEC) derived based on the Consumer Price Index (CPI). The Modification would apply this price cap to any Capacity to be used in future, post implementation, regardless of when it was booked. In the case of Capacity booked prior to the implementation of UNC 0678A the CPI Uplift would be applied to the price at the time of the auction rather than the floating price. Our primary concern is that this effectively replicates the Interim Contracts previously proposed and rejected under UNC 0621. • National Grid believes the proposal would introduce a form of price protection to contracts struck from 06 April 2017 onwards, for use in any period post implementation. The Modification proposed has two distinct pricing impacts to consider, the period between implementation of TAR on 06 April 2017 and 30 September 2020, and the period post UNC 0678A implementation on 01 October 2020. • Believes the first impact is most significant as it applies the proposed price cap to the auction prices associated with Capacity booked in the previous pricing regime, where the majority of charges were collected via the “top-up” commodity charges, and so the capacity prices were not reflective of the costs to be recovered. The price uplift, calculated based on a forecast of CPI for the periods modelled, would not necessarily trigger an increase to the auction price once rounded to four decimal places. The resulting prices calculated are lower than the expected “floating” price to be applied to all Capacity purchased after this period. • Noted that National Grid will continue to collect the same total Revenue and so any costs not recovered from a User (or Users) due to application of this additional layer

			of price protection will result in higher prices being passed on to all other Users. The levels of impact on any annual period will vary due to the bookings applicable to the period but exceed £30m per year on a number of occasions based on the analysis provided by both National Grid and the Proposer. This level of impact results in an increase to the Entry Transmission Services Rate of up to 5.9% based on previous analysis. • National Grid already see a marked influence in the prices due to price protected contracts, known in the GB market as Existing Contracts. This Modification would create further distortion, providing a small number of Users with a competitive advantage which would not be afforded to others, and so we believe the Modification negatively impacts on Relevant Objective d) and Relevant Charging Methodology Objective c). • Notes the second relates to the application of a price cap to QSEC auctions occurring following the implementation of UNC 0678A on 01 October 2020 which introduced the floating price structure to the GB market. This portion of the Modification is not expected to have a significant impact, but any price reduction due to application of the Price Cap will be picked up by other Users, driving up the Reserve Prices, even if the materiality is low. • National Grid would request that the Modification, if approved, be effective from the 01 of October of any given year. The timescales provided by the ROM suggest a project stand up time of three months and a further 12-14 weeks to implement the changes, which would suggest a decision publication would be required no later than 01 April in that same year. • Noting that this should leave time to assess and account for the impact of the Modification on prices prior to publication of the IP Auctions in late May. • Believes an enduring solution will cost at least £115,000, but probably not more than £150,000. • Agrees the Legal Text satisfies the solution outlined in the Modification. **Answer to Panel Questions:** • Q1: Provide views on whether this Modification is suitable for Self-Governance procedures. ○ National Grid believes there is a material impact on Users if this Modification were to be implemented and so should be considered for Authority Direction.

			Quantifying the potential impacts on future prices is difficult as it is difficult to accurately predict future prices, but National Grid do know that the impact of applying this new price cap to contracts purchased in the period between 06 April 2017 and 30 September 2020, does increase Reserve Prices, negatively impacting some Users over the next 10 years. • Q2: Provide views on whether there are any compliance issues associated with this Modification. ○ The introduction of a form of price protection for contracts booked during the interim period, between implementation of TAR NC on 06 April 2017 and implementation of UNC 0678A on 01 Oct 2020, is similar in nature to the proposed introduction of Interim/Historical Contracts under UNC0621 (and alternatives). This Modification was previously rejected by Ofgem as it was not considered to be compliant under the EU Tariff Network Code, now retained in UK Law. ○ As a consequence of price protected Capacity which already exists in the market, we see an increase in Reserve Prices to compensate for under recovery associated with lower priced Capacity. Any extension of price protection may raise concerns that prices could rise further to compensate and be levied against a reduced User base. The small and shrinking denominator used to calculate the Reserve Prices would result in a decreased likelihood of price stability and predictability. • National Grid would like to draw attention to the Analysis mentioned above which was published on the Joint Office website as part of the UNC0751 Workgroups on 02 March 2021 (NGG) and 02 February 2021 (WWA). https://www.gasgovernance.co.uk/0751/020321 https://www.gasgovernance.co.uk/0751/020221
PETRONAS UK	Support	c) Positive d) Positive g) Positive Charging: c) Positive e) Positive	• Petronas UK believes the impact of the implementation of Modification 0678A on Long Term Entry Capacity purchases and decision making has been twofold. • 1. Future purchasing of Long-Term Entry Capacity. ○ Future Gas Transportation charges play a significant role in determining the viability of investing in infrastructure projects and in concluding future commercial agreements with suppliers and other stakeholders. A lack of visibility and certainty

			in relation to those charges and the inability to lock in future pricing acts as an impediment to any decision making and discourages commitment where the purchase of Long-Term Entry Capacity is required. With the increases in capacity pricing we have seen since October 2020 and the introduction of the RRC, it is difficult to envisage any stakeholder being attracted to a long-term commitment to purchasing entry capacity at the current time. The lack of sales in recent QSEC auctions bears testament to this. • 2. Long Term Entry Capacity Purchased post April 2017. ○ A dual pricing system for holders of Long-Term Entry Capacity has been created based on nothing more than purchase date being prior or post 5-April 2017 which was retrospectively applied. In many cases Shippers now find that the costs they face are multiples of those that Shippers at the same entry point to the network may face and that the costs factored into historical commercial agreements and commitments are no longer valid by some distance. The fact that prices of QSEC secured in auctions post April 2017 could then be subject to such significant change as a result of a subsequent Modification will be of huge concern to any future potential investors. • Believes as a result of this an uneven playing field has been created whereby some Shippers have a huge competitive advantage over others. Again, this discriminatory situation that has been allowed to develop is a discouraging factor with regards investment and future commitment, acts as a barrier to entry for new market participants and could exclude affected Shippers from being able to compete and attract gas supply to the UK market. • Believes this Modification would go some way to addressing both of the above situations. • Believes that given the change would apply to Long Term Capacity purchased after 5 April 2017 there is no reason to delay implementation following approval. • No direct additional costs were identified as a result of implementation. • Legal Text satisfies the intent of the solution. **Answer to Panel Questions:**

			• Q1: Provide views on whether this Modification is suitable for Self-Governance procedures.
			  ○ It should not be subject to Self-Governance.
			• Q2: Provide views on whether there are any compliance issues associated with this Modification.
			  ○ N/A

Shell Energy Europe Limited (SEEL)	Oppose	c) Negative
		d) Negative
		g) Negative
		Charging:
		c) Negative
		e) Negative
			• SEEL does not support this proposal on the basis that it risks inflating prices for other Users, which is detrimental to creating a competitive level playing field for the purchase of capacity.
			• SEEL notes National Grid's assessment of future impacts, which outlined the risk that if prices rise and people begin to take advantage of this Modification, there could be a spiralling problem of a dwindling base over which to recover their Allowed Revenue. While National Grid has stated this is unlikely to happen at the moment, UK gas market players have recently been subject to almost unprecedented tariff uncertainty and volatility and what might be true for the moment does not guarantee what might be true in future years. The proposal also risks creating perverse capacity booking incentives.
			• In addition, SEEL share the concerns raised in the Workgroup report that the Proposal might not be compliant with the NC TAR, which indicates that the "'floating payable price' means a price calculated in accordance with Article 24(a) where the reserve price is subject to adjustments such as revenue reconciliation, adjustment of the allowed revenue or adjustment of the forecasted contracted capacity." It does not foresee adjustments in the form of a price cap.
			• No comment provided on the Impacts and costs or Legal Text.
			Answer to Panel Questions:
			• Q1: Provide views on whether this Modification is suitable for Self-Governance procedures.
			  ○ No comment provided.
			• Q2: Provide views on whether there are any compliance issues associated with this Modification.
			  ○ No comment provided.

Storengy UK Limited	Support	c) Positive d) Positive	• Storengy UK supports their Modification proposal, as Storengy UK believe that by applying a price cap for long term capacity acquisitions, this proposal enables long

		g) Positive Charging: c) Positive e) Positive	term capacity booking and investment in industry facilities and services, helping to maintain a competitive environment to keep consumer costs to a minimum. • Noted, Under the new charging regime, that came into effect on the 01 October 2020, any NTS capacity acquired is charged at the prevailing price at the time that the capacity is due to be utilised. Therefore, for long term capacity acquisitions, the price to be charged for the capacity is unknown at the time of acquisition, with the party acquiring the capacity currently liable for a potentially high and unknown charge. This makes long term capacity acquisition an extremely high financial risk and provides a huge disincentive for any associated investment in industry facilities and services. Storengy UK's Modification proposes to benchmark the long-term cost of the capacity against the costs of the capacity at the time of acquisition, allowing potential investors to ascertain a future charging value for the capacity in evaluating whether or not to invest. • Believes the current charging regime discourages longer term investment in industry projects requiring NTS capacity (e.g. facility and service investment) as future NTS capacity charges are unknown until shortly before they are applied. This is currently harming the competitive environment, with the situation only continuing to worsen with time, and this is likely to increase costs for end consumers if not addressed. • Therefore, Storengy UK believe that these proposals should be implemented as soon as possible after any Authority direction to do so, to aid in the ongoing welfare of investment in the current and future industry, and to ensure consumer costs are kept to a minimum. • Believes the new NTS capacity charging regime, which started on the 01 October 2020, has resulted in all new NTS capacity auction acquisitions being made in the short-term and medium-term capacity auctions, both to minimise capacity costs by closer matching capacity bookings to flows, and because the cost of capacity is unknown until close to the time when it is to be utilised. This has effectively added a barrier to new longer-term capacity acquisition and created a lot more uncertainty in forecasting capacity bookings for the setting of yearly capacity charges. Storengy UK's Modification seeks to re-enable the acquisition of capacity for the longer term, and encourage ongoing investment in industry facilities and services, through adding parameters to control the future potential charging liability as a result of acquiring

			capacity for the longer term. • Believes, the introduction of the new charging regime has also created discrimination between long-term quarterly capacity booked before 05 April 2017 (Existing Contracts), and long-term quarterly capacity booked since this date but before the new charging regime came into effect. Existing Contract quarterly capacity bookings are charged at the prices agreed at the time that the capacity was acquired, whereas quarterly capacity acquired since 05 April 2017 is subject to the capacity charges at the time of utilisation (prevailing price). This has resulted in Existing Contract holders benefiting from the knowledge of a fixed price liability for capacity bookings, whereas more recent acquisitions of long-term capacity carry huge financial risk as the potential capacity costs are unknown. Storengy UK's Modification addresses this by applying charging parameters for more recent long-term bookings. • Feels with the booking of long-term capacity currently effectively unfeasible under the new charging regime (due to the unknown and potentially high-capacity charging liability), a major barrier for investments in any industry projects requiring NTS capacity for the longer term has been introduced. The uncertainty of these costs has already seen reductions in industry facility investment such as the mothballing and scaling down of sites, and also impacted future investments with some new projects being put on hold. • Believes, if this issue is not addressed these impacts are only going to continue, with investors looking for more secure investments in other industries. Storengy UK's proposal helps to provide investors with some security around future costs, enabling them to better evaluate risks and opportunities for industry projects and investments, and encouraging ongoing investment in facilities and services. • Storengy UK believes that their Modification proposal will only benefit the industry as it helps to redress the balance between long-term and short-term capacity bookings, enabling capacity to be acquired for the longer term. This will help in the accuracy of forecasting yearly capacity bookings, and should reduce the volatility of yearly capacity prices, giving greater financial certainty to all members of the industry. In addition, it will encourage longer term investment in the industry facilities and services, ensuring that network costs will continue to be distributed between a large number of shippers, rather

			than costs being distributed between a smaller number of shippers as investors move to other industries, and ultimately helping to ensure that consumer costs are kept to a minimum. • Storengy UK is satisfied that the legal text will deliver the intended solution. **Answer to Panel Questions:** • Q1: Provide views on whether this Modification is suitable for Self-Governance procedures. ○ Storengy UK believes that this Modification is potentially suitable for Self-Governance as the year to year financial impact on the wider industry is expected to be fairly low. However, with the possibility of volatile year to year prevailing prices changing shippers behaviour, the financial impact on charging revenues could become more material, and so Storengy UK believe that Authority Direction may be more suitable. • Q2: Provide views on whether there are any compliance issues associated with this Modification. ○ Storengy UK believe that this Modification is fully compliant with the EU Tariff Code, as shown in the legal opinion provided https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2021-02/WWA%20Opinion%20UNC%200751%20and%20TARFINAL230221.pdf To ensure compliance with EU Tariff Code, acquisition of NTS capacity by Interconnectors is not included within these proposals. • Believes due to the uncertainty of the current impact of the new regime on different shippers, it is difficult to assess the likelihood of future long-term quarterly bookings and their liabilities being retained, especially in light of the substantial increase in costs for some more recent long-term capacity bookings. In the impact assessments carried out for our modification, we have assumed, in good faith, that all future liabilities for long-term capacity bookings will be retained and paid in full.
Vermilion Energy Ireland Limited	Oppose	c) Negative d) Negative g) Negative Charging: c) Negative	• Vermilion Energy Ireland believes implementation of the Modification would lead to a situation in which in the same delivery period shippers pay different tariffs for the same product. In Vermilion's opinion "same product, same tariff" should apply. Although Vermilion Energy

		e) Negative	Ireland do not support the current arrangements in the German market, at least these German arrangements foster the concept "same product, same tariff", as shippers can choose between paying the respective actual (floating) tariff, or otherwise hand back the capacity (so: no product, no tariff payment). • Does not support implementation. • No comments on Impacts and Costs or Legal Text provided. **Answer to Panel Questions:** • Q1: Provide views on whether this Modification is suitable for Self-Governance procedures. ○ This Modification would lead to different tariffs for the same product, so not suitable for Self-Governance procedures. • Q2: Provide views on whether there are any compliance issues associated with this Modification. ○ Implementation of the Modification would lead to a situation in which in the same delivery period shippers pay different tariffs for the same product. In Vermilion's opinion "same service, same tariff" should apply.

Please note that late submitted representations will not be included or referred to in this Final Modification Report. However, all representations received in response to this consultation (including late submissions) are published in full alongside this Report and will be taken into account when the UNC Modification Panel makes its assessment and recommendation.

11 Panel Discussions

Discussion

The Panel Chair summarised that Modification 0751 would introduce a cap on the maximum price payable for Long-Term Entry Capacity to ensure equitability in the charging treatment of Long-Term Capacity products and facilitate investment in gas supply facilities.

Panel Members considered the representations made noting that, of the 6 representations received 3 supported implementation, and 3 were not in support.

Arguments from the Proposer and those who supported through their responses would argue that this Modification will help improve the accuracy of forecasting yearly capacity bookings, and should reduce the volatility of yearly capacity prices, giving greater financial certainty to all members of the industry. In addition, some Panel Members believed the Modification will go some way to address the discriminatory situation that has been allowed to develop in relation to the dual pricing system for holders of Long-Term Entry Capacity.

Some Panel Members agreed with some opposing consultation responses that the principle of "same product, same tariff" should apply and that the Modification should be opposed on the grounds of furthering a dual regime, and extending the protection given by EU Tariff Network Code Article 35(1). The Modification appears to be somewhat of an unwinding of Modification 0678A.

A Panel Member believed that no evidence of consumer benefit from this Modification has been shown.

Consideration of the Standard Relevant Objectives

Panel Members considered Relevant Objective c) *Efficient discharge of the licensee's obligations,* agreeing that implementation and did not believe there was any evidence for impact on Relevant Objective c).

Some Panel Members considered that implementation of the Modification would have a negative impact on Relevant Objective d) *Securing of effective competition*, because it offers a carve out for some users which is generally not a good factor for competition, and no evidence is given that this Modification is positive for competition.

Some Panel Members considered this Modification would create further distortion in relation to the pricing of capacity by extending the scope of the protection afforded to a subset of the market, providing a small number of Users with a competitive advantage which would not be afforded to others. Entrants after April 2017 have a competitive disadvantage in terms of pricing.

Panel Members considered Relevant Objective *f) Promotion of efficiency in the implementation and administration of the Code*, and did not believe there was any evidence for impact on Relevant Objective f)

Consideration of the Relevant Charging Objectives

Panel Members considered Relevant Charging Objective *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;* agreeing that implementation would have a negative impact because of the diminishing pool of those Entry customers amongst whom the burden of the relevant part of Allowed Revenue must be shared.

Panel Members considered Relevant Charging Objective *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,* and agreed there was a negative impact due to the Modification furthering a form of price protection. This appears to be similar in nature to the proposed introduction of Interim/Historical Contracts under UNC0621 (and alternatives), this Modification was previously rejected by Ofgem as it was not considered to be compliant under the EU Tariff Network Code, now retained in UK Law. Modification 0678A did not have this extended form of protection within it and was deemed compliant.

Determinations

Panel Members voted unanimously that Modification 0751 does not have an SCR impact.

Panel Members voted unanimously that no new issues were identified as part of consultation.

Panel Members voted unanimously that the Modification should not follow Self-Governance procedures as it was considered to be a material change.

Panel Members voted unanimously against recommending implementation of Modification 0751.

12 Recommendations

Panel Recommendation

Panel Members recommended:

- that Modification 0751 should not be implemented.