Modification proposal:	**Uniform Network Code (UNC) 751: Capping price increases for Long-Term Entry Capacity (UNC751)**		
Decision:	The Authority[1] has decided to reject this modification[2]		
Target audience:	UNC Panel, Parties to the UNC and other interested parties		
Date of publication:	29 October 2021	Implementation date:	n/a

Background

On 28 May 2020, we approved modification proposal UNC678A - Amendments to Gas Transmission Charging Regime (Postage Stamp)[3]. UNC678A introduced significant reforms to the Great Britain (GB) gas transmission charging arrangements which became effective on 1 October 2020 and ensured compliance with Commission Regulation (EU) 2017/460 of 16 March 2017 establishing a network code on harmonised transmission tariff structures for gas (TAR NC)[4].

Prior to the implementation of UNC678A, a fixed capacity price applied to entry capacity bought at the Quarterly System Entry Capacity (QSEC) auctions. These contracts were subject to a floating commodity charge which recovered the majority of allowed Transmission Owner (TO) revenues.

Under UNC678A, transmission services revenue[5] is recovered through capacity charges. Capacity bookings are subject to a floating price, with the exception of certain fixed-price

[1] References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.
[2] This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986
[3] Amendments to Gas Transmission Charging Regime: Decision and Final Impact Assessment (UNC678/A/B/C/D/E/F/G/H/I/J) (28 May 2020) https://www.ofgem.gov.uk/publications/amendments-gas-transmission-charging-regime-decision-and-final-impact-assessment-unc678abcdefghij
[4] Now incorporated in UK law by the European Union (Withdrawal) Act 2018 and the European Union (Withdrawal Agreement) Act 2020, as amended by Schedule 5 of the Gas (Security of Supply and Network Codes) (Amendment) (EU Exit) Regulations SI 2019/531.
[5] Article 3(6) TAR NC states: "Transmission services revenue" means the part of the allowed or target revenue which is recovered by transmission tariffs.

capacity bookings and contracts registered prior to 6 April 2017 which are classified as "existing contracts" in accordance with Article 35 TAR NC.

The modification proposal

Storengy (the Proposer) raised UNC751: 'Capping price increases for Long-Term Entry Capacity'[6] proposing to introduce a cap on the price paid by holders of QSEC at domestic entry points.

The Proposer states that the introduction of UNC678A 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. The Proposer argues that 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 National Transmission System (NTS) delivery rights in order to secure project financing.

UNC751 proposes that 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. Interconnection Points (IPs) are excluded from the proposed price cap. 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.

UNC Panel[7] recommendation

At the UNC Panel meeting on 17 June 2021, UNC Panel Members considered that UNC751 would not better facilitate the UNC objectives and voted unanimously against recommending its implementation.

Some Panel Members considered that implementation of UNC751 would have a negative impact on Relevant Objective (d), because it offers a "carve out" for some users, saying that

[6] https://www.gasgovernance.co.uk/0751
[7] The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

this is generally not a good factor for competition, and noting that no evidence is given that UNC751 is positive for competition. Some Panel Members considered UNC751 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. Panel members considered that entrants after April 2017 have a competitive disadvantage in terms of pricing.

Panel Members considered Relevant Charging Objective (c)and concluded 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 also considered Relevant Charging Objective (e) and concluded that there was a negative impact due to the modification extending a form of price protection. Panel members also noted that this appears to be similar in nature to the proposed introduction of Interim/Historical Contracts under UNC621 (and alternatives), which was rejected by Ofgem.

Our decision

We have considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 18 June 2021. We have considered and taken into account the responses to the industry consultation on the modification proposal which are attached to the FMR[8]. We have concluded that:

- implementation of the modification proposal will not better facilitate the achievement of the relevant methodology objectives of the UNC;[9]
- directing that the modification be made would not be consistent with our principal objective and statutory duties.[10]

[8] UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.co.uk
[9] As set out in Standard Special Condition A11(1) of the Gas Transporters Licence: https://epr.ofgem.gov.uk//Content/Documents/Standard%20Special%20Condition%20-%20PART%20A%20Consolidated%20-%20Current%20Version.pdf
[10] The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

Reasons for our decision

We consider this modification proposal will not better facilitate UNC Relevant Code Objectives (d) and (g) and UNC Charging Methodology Relevant Objectives (CMROs) (aa), (c) and (e). Given the similarities between the applicable UNC objectives we assess them in tandem.

Objective (d) Securing of effective competition and CMRO 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, and CMRO Objective (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

We consider that the proposal does not better facilitate and would have a negative impact on UNC Relevant Code Objective (d) and CMROs (c) and (aa).

The Proposer argues that UNC751 furthers competition between shippers by ensuring they are able to gain access to the NTS on a more equitable basis. The modification states that:

'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.'

UNC678A implemented protections for "existing contracts" in accordance with Article 35(1) TAR NC. We have previously[11] said that there is a tension between Article 35(1) TAR NC and

[11] See for instance UNC739: Aggregate overrun regime for Original Capacity held at the Bacton ASEPs (20 August 2021) https://www.ofgem.gov.uk/publications/unc739-aggregate-overrun-regime-original-capacity-held-bacton-aseps

other legislative requirements in TAR NC and the Gas Regulation[12] regarding efficient competition. Following the implementation of UNC678A, existing contracts offer access to entry capacity for a significantly lower average price than capacity which is not protected under Article 35(1) TAR NC and is subject to a floating price. As a result, protection for existing contracts has led to a dual regime in the GB charging methodology where NTS users face significantly different costs for capacity depending on their access to existing contracts. This impacts effective competition.

A respondent to the industry consultation noted that:
"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 UNC0678A implementation on 01 October 2020. 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".

We agree with the above statement. The previous charging regime that applied until 30 September 2020 was predominantly commodity-based and capacity charges made a small part of the overall transmission tariff. On the other hand, the new charging regime which was implemented on 1 October 2020 is predominantly capacity-based. Therefore, the main beneficiaries from UNC751 would be those users who purchased long-term capacity between 6 April 2017 and 30 September 2020, as they would be able to preserve the low capacity price at the time of assignement (adjusted by CPI).

Consenting to modification UNC751 would exacerbate the problems caused by existing contracts as it would effectively expand the scope of capacity bookings that are treated as "existing contracts". This would provide an undue competitive advantage to those users who will mostly benefit from this modification (ie those who purchased long-term capacity between 6 April 2017 and 30 September 2020), whilst disadvantaging further other holders of "new capacity" (purchased after 6 April 2017) who will pay the full floating price.

[12] Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks, now incorporated in UK law in accordance with the European Union (Withdrawal) Act 2018 as amended by the European Union (Withdrawal Agreement) Act 2020.

The effect of UNC751 would be similar to the concept of "interim contracts" which we have previously rejected.[13] We also note that in recent years we have rejected a number of other modification proposals which concerned long-term entry capacity assigned between 6 April 2017 and the date of TAR NC implementation in GB.[14]

We recognise that users who would purchase long-term entry capacity following the implementation of UNC678A on 1 October 2020 would not benefit as much as those who purchased long-term entry capacity between 6 April 2017 and 30 September 2020. However, we consider that re-introducing fixed prices for long-term entry capacity at domestic points would entail undue discrimination and disadvantage holders of short-term entry capacity and entry capacity at IPs who will pay the full floating price.

For these reasons, we consider that UNC751 does not better facilitate and would have a negative impact on UNC Relevant Code Objective (d) and the CMROs (c) and (aa).

Objective (g) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Cooperation of Energy Regulators and CMRO Objective (e) compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Cooperation of Energy Regulators

We consider that UNC751 does not better facilitate and would have a negative impact on UNC Relevant Code Objective (g) and the CMRO (e).

The Proposer refers to Article 13 of the Gas Regulation[15] which requires (among other things) that tariffs shall:

(i) be applied in a non-discriminatory manner;

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[13] Capacity contracts registered during the period from April 2017 until the date of implementation of TAR NC in GB were called "interim contracts" as part of the UNC621 modifications. In our 621 decision, we concluded that interim contracts are not a recognised category of contract under TAR NC and are non-compliant with the applicable legislation; see Uniform Network Code (UNC) 621/A/B/C/D/E/F/H/J/K/L: Amendments to Gas Transmission Charging Regime, pages 5-6 available at: https://www.ofgem.gov.uk/publications/uniform-network-code-unc-621abcdefhjkl-amendments-gas-transmission-charging-regime
[14] UNC678F: Amendments to Gas Transmission Charging Regime – Treatment of Unprotected Entry Capacity and Storage; UNC738: Incremental NTS Entry Capacity Surrender
[15] UN751 refers to Article 13 TAR NC but we consider that this is meant to be reference to Article 13 of the Gas Regulation.

(ii) facilitate efficient gas trade and competition, while at the same time avoiding cross-subsidies between network users and providing incentives for investment; and

(iii) neither restrict market liquidity nor distort trade across borders of different transmission systems.

The Proposer also refers to the GB Report by the Agency for the Cooperation of Energy Regulators (ACER) which found that existing contracts "[lead] to a situation of 'dual regime' that could potentially be considered as discriminatory, since comparable capacities will face different tariff conditions".[16] The Proposer argues that as a result of the protection granted to existing contracts, long-term capacity acquired after 6 April 2017 is exposed to higher and variable charges, which leads to discriminatory treatment of users of the same product on the basis of the date on which it is purchased. The Proposer says that this is inconsistent with Article 13 of the Gas Regulation and aligns with the view expressed by ACER.

Finally, the Proposer also says that TAR NC permits charges to be levied at different rates for different products, noting that the application of alternative multipliers and seasonal factors explicitly allows for different reference prices and reserve prices to be applied across different products.

As we said previously, we agree that there is a tension between Article 35(1) TAR NC and other legislative requirements such as Article 7(c) in TAR NC and the Gas Regulation regarding efficient competition and that protection for existing contracts has led to a dual regime[17]. However, the solution proposed by UNC751 would exacerbate rather than alleviate the problems caused by existing contracts as it would effectively expand the scope of capacity bookings that are treated as "existing contracts" to include long-term capacity bought after 6 April 2017. We also agree with Panel that UNC751 would have the effect of introducing the concept of "interim contracts", given that it would mostly benefit users who purchased long-term entry capacity between 6 April 2017 and 30 September 2020.

[16] Agency Report - Analysis of the Consultation Document for Great Britain, para. 57 https://documents.acer.europa.eu/Official_documents/Acts_of_the_Agency/Publication/Agency%20report%20-%20analysis%20of%20the%20consultation%20document%20for%20Great%20Britain.pdf

[17] See for instance page 7 of Amendments to Gas Transmission Charging Regime: Decision and Final Impact Assessment (UNC678/A/B/C/D/E/F/G/H/I/J) (28 May 2020) https://www.ofgem.gov.uk/publications/amendments-gas-transmission-charging-regime-decision-and-final-impact-assessment-unc678abcdefghij

Finally, in the current regime, all capacity products are subject to the same multiplier of "1.0". In UNC678A, we said that in the context of a meshed network largely operating below capacity with expected declining demand, and product multipliers of "1.0", would allow "market participants to profile capacity bookings close to actual flows using short-term capacity products (eg daily and within day capacity products), thus minimising the costs associated with over-booking of capacity".[18] Under TAR NC, long-term capacity products may be subject to lower multipliers[19] than short-term capacity to incentivise the uptake of long-term capacity products. To date, such a solution has not been proposed.[20] If such a solution were proposed, it would require careful assessment of its impacts (including but not limited to the applicable Forecasted Contracting Capacity methodology). However, the fact that under TAR NC it is permissible to have different multipliers or seasonal factors for different capacity products is not relevant to UNC751.

For these reasons, we consider that UNC751 does not better facilitate and would have a negative impact on UNC Relevant Code Objective (g) and the CMRO (e).

Our principal objective and statutory duties

The Authority's principal objective is to protect the interests of existing and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution or transmission systems.

In cases where UNC751 would lead to significantly lower charges for certain users (ie in particular for those who purchased long-term entry capacity between 6 April 2017 and 30 September 2020) this would however have a concomitant adverse effect for all other users by increasing costs. For these reasons, we consider that directing that the modification be made would not be consistent with our principal objective and statutory duties.

[18] See UNC678A decision (28 May 2020), page 20 https://www.ofgem.gov.uk/publications/amendments-gas-transmission-charging-regime-decision-and-final-impact-assessment-unc678abcdefghij
[19] Article 3(16) TAR NC.
[20] We note that on 5 March 2021, we published our Article 28(2) TAR NC consultation which covered (inter alia) the issue of multipliers and seasonal factors and we did not receive any responses: https://www.ofgem.gov.uk/publications/article-282-tar-nc-motivated-decision

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters licence, the Authority has decided that modification proposal UNC751: 'Capping price increases for Long-Term Entry Capacity' should not be made.

David O'Neill
Head of Gas Markets and Systems
Signed on behalf of the Authority and authorised for that purpose