Modification proposals:	**Uniform Network Code (UNC) 0687V: Creation of new charge to recover Last Resort Supply Payments (UNC0687V) and 0797: Last Resort Supply Payments Volumetric Charges (UNC0797)**		
Decision:	The Authority[1] directs modification UNC0797 be made[2] The Authority directs modification UNC0687V be rejected		
Target audience:	UNC Panel, Parties to the UNC and other interested parties		
Date of publication:	20 January 2022	Implementation date:	01 April 2022

Background

Gas and electricity are supplied to customers through a competitive process in Great Britain. Competition has the potential to bring many benefits to consumers, but a competitive process may lead to companies failing. The gas and electricity supply market is no exception. Ofgem ensures continuity of supply to the failed supplier's customers and prevents wider market impacts by appointing a Supplier of Last Resort (SoLR). This process also provides protection for the credit balances of the failed supplier's residential customers.

Electricity and gas suppliers' licences allow SoLRs (in some circumstances) to make a claim for the otherwise unrecoverable costs that they have incurred in being a SoLR. This is paid by a "levy" on gas transporters and electricity distributors' Distribution Use of System (DUoS) charges which are then recovered from consumers.

The modification proposals

Total Gas & Power Limited (the "Proposer") raised UNC0687 (Creation of new charge to recover Last Resort Supply Payments) on 10 May 2019. The modification proposes to create

[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.

and add a new specific charge (SoLR Customer Charge) to the current Gas Distribution Operators Charging Methodologies. Cost recovery of this charge will be based on whether a site is domestic or non-domestic, depending on the market sector flags maintained by Xoserve as determined at the time of issuing the invoices. The modification was designed to improve the baseline as it would allow a more accurate cost-targeting to the market sector the SoLR costs originate from.

At the UNC Panel meeting on 19 September 2019, the Panel Members unanimously recommended the approval of UNC0687. Ofgem reviewed the information provided, however we were unable to form an opinion on UNC0687 at the time, on the basis that the Final Modification Report (FMR) stated that there were errors in the Legal text. The Authority issued a send back letter[3] on 09 October 2019, asking for the Legal Text to be revised and submitted for determination. Panel Members reviewed the updated Legal Text and voted unanimously to return the Modification to the Authority for consideration on 17 October 2019.

The Authority issued another send back letter on 07 December 2021 and our minded to position on UNC0687 asking for the Legal Text to be updated to reflect the current version of the UNC.[4] On 14 December 2021, Panel Members voted by majority vote that the variation to UNC0687 was material and that UNC0687V should be issued to consultation.

Corona Energy (the "Alternative Proposer") raised UNC0797 (Last Resort Supply Payments Volumetric Charges) on 22 December 2021. The Alternative Proposer requested that UNC0797 be treated as an Urgent modification proposal. On 23 December 2021, we published our decision to grant urgency to UNC0797, as we considered that this modification is linked to an imminent issue which if not urgently addressed would have significant commercial impact on consumers and parties. We also stated that we consider UNC0797 to be an alternative to UNC0687 and that we expect UNC0797 to progress in time so that we can assess both modifications.[5]

We received the FMR for UNC0687V and UNC0797 on 12 January 2022.

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[3] Authority decision to 'send back' Uniform Network Code ("UNC") 687 ("UNC687"): 'Creation of new charge to recover Last Resort Supply Payments' (gasgovernance.co.uk)

[4] Authority decision to 'send back' Uniform Network Code ("UNC") 687 ("UNC687"): 'Creation of new charge to recover Last Resort Supply Payments' | Ofgem

[5] UNC modification proposal UNC0797: 'Last Resort Supply Payments (ofgem.gov.uk)

UNC0797 creates a new charge type to be used to recover LRSPs from SoLRs. The proposed solution allocates the costs to specific sectors where these originated from based on a volumetric unit rate, in order to provide a fairer apportionment. New charge types for Domestic and Non-Domestic users using existing Shipper maintained Market Sector Codes will allocate value to each sector. This will then be allocated using a volumetric basis so that customers are charged in line with their consumption, as opposed to a flat rate.

The Alternative Proposer believes that the modification better facilitates relevant UNC charging objectives (a) and (c). They note that the modification will require transporters to amend their Charging Methodologies to incorporate the new requirement in the recovery of LRSP costs and ensure that they are targeted at the originating market. The Alternative Proposer believes that this will make the costs more reflective of source market and further competition by applying these costs in a fair and transparent manner.

UNC Panel[6] recommendations

At the UNC Panel meeting on 12 January 2022, the UNC Panel Members, with 11 out of 14 votes in favour, recommended implementation of modification proposals UNC0687V and UNC0797. Panel Members considered, should one of the Modifications (UNC0687V or UNC0797) be implemented, the one which better facilitated the Relevant Objectives was UNC0797 (Urgent) rather than UNC0687V. UNC0797 (Urgent) received 3 preference votes in favour (out of 14 possible).

Our decision

We have considered the issues raised by the modification proposals and the FMR dated 12 January 2022 for UNC0687V and UNC0797. We have considered and taken into account the responses to the industry consultations on the modification proposals which are attached to the FMRs[7]. We have concluded that:

[6] The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.
[7] UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.co.uk

- implementation of UNC0797 will better facilitate the achievement of the relevant methodology objectives of the UNC;[8] and
- directing that UNC0797 be made is consistent with our principal objective and statutory duties.[9]

Reasons for our decision

We consider that both modification proposals will better facilitate UNC relevant charging methodology objectives (a) and (c). We believe that the solution proposed in UNC0797 brings marginally better benefits therefore we want this to be implemented and we reject UNC0687V.

(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[10]

The Proposer believes that UNC0687V aligns the cost recovery mechanism that is operated in the UNC with the current LRSP process, in which cost apportionment is based on Supply Meter Points and does not include IGT Supply Meter Points. This will ensure cost recovery by DNOs is reflective of the costs incurred, therefore facilitating charging UNC objective (a).

The Alternative Proposer believes that UNC0797 requires transporters to amend their Charging Methodologies to incorporate the new requirement in the recovery of LRSP costs. This ensures that they are targeted at the originating market. This will make the costs more reflective of source market the costs originate from, therefore facilitating charging UNC objective (a).

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

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

[10] UNC 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
UNC objective (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)

The Panel considered both modifications on 12 January 2022. Some Panel Members agreed that implementation would have a positive impact because it would reduce or remove cross-subsidisation of SoLR events from other market sectors (e.g. between domestic and non-domestic). They believed that costs would be more appropriately targeted and system changes (XRN4992) are being progressed at risk and have been visible for some time. Other Panel Members believe that UNC0797 would be neutral to this objective as it is impossible to assess compliance with the charging methodology in the time given and there was no evidence of any impact assessment.

Some Panel Members stated that both modifications would have a negative impact to this objective, as it would introduce uncertainty and possibly additional unforeseen risk to some domestic suppliers and customers. Also, they argued that implementing one of the modifications would pose a higher risk relating to system changes done at shorter timescales than usual, mentioning the concern from the Central Data Services Provider (CDSP) around its delivery and support of critical production services and processes in the near future.

Our position

We believe that both UNC0687V and UNC0797 better facilitate this objective, as they provide an improvement to the baseline arrangements. As noted in our recent send back letter on UNC0687, it is our policy intention to allocate SoLR costs to the market sector they originate from. Both modifications would benefit consumers as they would enable a reduction of cross-subsidisation as a result of SoLR events, with the SoLR costs being recovered from the relevant consumers.

These modifications would need to be in place for April 2022, therefore we believe it is necessary to shorten the timescales for this modification. We explain, in a separate section of this decision letter, the reasons why we believe that carrying out an Impact Assessment is impracticable on this occasion although we and the Panel have considered the various information and assessments raised through the modification process and included with the FMR report.

Panel Members raised concerns regarding implementation risks for both modifications. However, we have recently engaged with relevant stakeholders to understand the challenges. We believe that despite the challenges, the system changes required to implement the modifications can be completed on time to benefit consumers. Although we appreciate this is a change in the charging arrangements, we do not agree with the view that the modifications would introduce uncertainty and unforeseen risk to some domestic suppliers and customers. UNC0797 proposes a change that we see as an alternative to UNC0687V; the latter is a modification that has been visible for some time and is being confirmed in line with the annual charge adjustment process.

(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[11]

The Proposer believes that UNC0687V would target the costs that occur from an SoLR event to the market sector in which they originated. This would support the promotion of competition between Gas Shippers and Gas Suppliers, better facilitating relevant UNC objective (c).

The Alternative Proposer believes that UNC0797 would target the costs that occur from an SoLR event to the market sector in which they originated. This would support the promotion of competition between Gas Shippers and Gas Suppliers, better facilitating UNC objective (c).

The Panel considered both modifications on 12 January 2022. Some Panel Members agreed that implementation of either UNC0687V or UNC0797 would have a positive impact because it would reduce or remove cross-subsidisation of SoLR events from other market sectors (e.g. between domestic and non-domestic) and costs would be more appropriately targeted.

Other Panel Members agreed that both modifications would have a negative impact because they would cause distributional impacts. Some Panel Members argued that UNC0797 would create a windfall for non-domestic suppliers and place an undue burden on specific customer types. They also argued that UNC0797 would unfairly penalise "prudent suppliers" who will have taken indicative distribution charges and the current LRSP regime into account. They stated that the modifications would not be implementable under the current price cap because it does not currently allow for fixed charge elements and the modification does not state it is contingent on a change to the price cap. Lastly, Panel members stated that both UNC0687V

[11] UNC charging objective (b) that, so far as is consistent with sub-paragraph (a), the charging methodology properly takes account of developments in the transportation business

and UNC0797 would pose an implementation risk given that the scale of the amount to be received is now so significantly higher than that envisaged under UNC0687.

Our position

Our view is that both UNC0687V and UNC0797 better facilitate relevant objective (c), and they improve the existing arrangements. We believe that competition is facilitated when costs are more appropriately targeted and this is ensured by allocating SoLR costs to the market they originate from. We agree with the three Panel Members that UNC0797, which is based on a volumetric approach, is marginally better than the fixed approach proposed by UNC0687V, as it is more cost reflective.

We understand Panel Members' concerns around distributional impacts as a result of the timeframes for considering both modifications. However, our view is that on this occasion, while there could be some negative distributional impacts these would be very small compared to the overall benefits of the UNC0797, considering the substantive SOLR levy costs at this time. We are mindful of the significant negative impact which current exceptional LRSP amounts could create for all customers and suppliers, but particularly those non-domestic suppliers who are operating with fixed term contracts which will not be able to reflect recent increases. The potential collateral impacts appear greater than any potential windfall which particular suppliers may receive through UNC0797.

We disagree with the view that UNC0797 would not be implementable under the price cap. We are aware of the link to the retail price cap and we recently consulted on changing the Price Cap Methodology to take account of how SoLR levy costs are recovered from gas consumers.[12] This consultation set out proposals to create a charge in the price cap methodology that will align with a new cost recovery mechanism. We will make a decision on amending the price cap methodology in due course.

Based on discussions with industry so far, we believe that the modifications can be implemented in time. Suppliers have known for a long time changes such as these may be

[12] A copy of the consultation paper can be found here: https://www.ofgem.gov.uk/publications/price-cap-consultation-reflecting-change-gas-solr-levy-costs-default-tariff-cap

made. We've also further explored the implementation challenges; based on discussions with industry so far, we are satisfied that these are manageable.

Decision not to conduct an Impact Assessment

In our letter regarding urgency on 23 December 2021, we decided that UNC0797 should be treated as an Urgent UNC Modification Proposal. In that letter, we noted that '[w]e consider this modification is linked to an imminent issue which if not urgently addressed would have significant commercial impact on consumers and parties."

Section 5A of the Utilities Act 2000 ("UA00") imposes a duty on the Authority (its "Section 5A duty") to undertake an impact assessment in certain circumstances. In particular, the duty applies where it appears to the Authority that a proposal is important. A proposal is important for these purposes if its implementation would be likely to, among other things, "have a significant impact on persons engaged in commercial activities connected with the … generation, transmission, distribution or supply of electricity." Where this applies, the Authority is obliged to carry out an impact assessment.

The Authority has not considered it necessary to do further impact assessments in order to reach this decision and does not consider it is required to do so by Section 5A of UA00. This is because of the exceptions to the Section 5A duty and the information and analysis already provided to us. Those exceptions apply if it appears to the Authority that the urgency of the matter makes it impracticable or inappropriate for the Authority to comply with the Section 5A duty.

The Authority considers it is impracticable to conduct an Impact Assessment under our Section 5A duty for this decision. The timeline for decision proposed in the FMR does not allow for a full Impact Assessment. We have considered the consultation responses accompanying the FMR, including the information on potential impacts of the modifications. We consider that these provide sufficient information to make a decision without further analysis. These modifications will need to take effect on 01 April 2022, given that the SoLR costs for 2022-23 are expected to be exceptionally high. In order to recover these from consumers in a more appropriate way and avoid the significant detriment which could arise if no change is made, the timescales for the progression of these modifications have been expedited.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters licence, the Authority hereby directs that modification proposal UNC0797: 'Last Resort Supply Payments Volumetric Charges' be made and that UNC0687V: 'Creation of new charge to recover Last Resort Supply Payments' be rejected.

Anna Rossington
Deputy Director, Retail
Signed on behalf of the Authority and authorised for that purpose