

Modification proposal:	Uniform Network Code (UNC) 739: Aggregate overrun regime for Original Capacity held at the Bacton ASEPs (UNC739)		
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:	20 August 2021	Implementation date:	n/a

Background

In 2015, we made changes to the National Grid Gas (**NGG**) National Transmission System (**NTS**) gas transporter licence in order to facilitate implementation of Commission Regulation (EC) No 984/2013 of 14 October 2013 establishing a Network Code on Capacity Allocation Mechanisms in Gas Transmission Systems (**CAM**). This change split the Bacton entry point commercially into two new entry points, ie Bacton UKCS³ and Bacton IP⁴. This change was made to ensure that CAM procedures are only applicable to capacity at the Bacton IP entry point.

On 21 July 2015, we approved modification proposal UNC501V.⁵ UNC501V introduced a one-off process that invited capacity holders to indicate whether they wished their entry capacity rights at the Bacton entry point to be reallocated to the Bacton UKCS, or at the Bacton IP, entry point following implementation of CAM.

Under UNC501V, where the aggregate level of capacity holders' requests for capacity to be reallocated to an entry point was less than or equal to the baseline capacity at that entry

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 UK Continental Shelf.

⁴ Interconnection Point.

⁵ Uniform Network Code (UNC) 0501V, UNC501AV, UNC501BV and UNC501CV: Treatment of Existing Entry Capacity Rights at Bacton (21 July 2015) <https://www.ofgem.gov.uk/publications/uniform-network-code-unc-0501v-unc501av-unc501bv-and-unc501cv-treatment-existing-entry-capacity-rights-bacton>

point, their entry capacity reallocations would be granted in full. Where this was not the case then a further invitation and reallocation process would be undertaken. If, after two such processes, the aggregate level of bookings to be reallocated was still in excess of the baseline capacity at one entry point, NGG would reapportion the capacity holdings such that the baseline capacity would not exceed the aggregate level of capacity holdings. Any remaining capacity would be reallocated to the other entry point.

The modification proposal

ENI (**the Proposer**) raised UNC739 proposing that entry capacity acquired at the Bacton ASEP before 1 November 2015 will be defined as “Original Bacton Capacity”. Where the aggregate amount of Original Bacton Capacity held by a shipper at the Bacton UKCS and Bacton IP ASEPs is greater than that shipper’s aggregate daily entry flows at the Bacton ASEPs, then an entry overrun charge will not be applied. Original Bacton Capacity transferred after the 1 November 2015 will not benefit from the proposed aggregate overrun mechanism. The Proposer considers that UNC739 will have a positive impact on UNC Relevant Code Objective (d).

UNC Panel⁶ recommendation

At the UNC Panel meeting on 18 February 2021, ten out of thirteen members of the UNC Panel considered that UNC739 would better facilitate the UNC objectives and the Panel therefore recommended its approval. Among the panel members representing consumers, the domestic consumer voting member did not recommend implementation; the non-domestic consumer voting member was not present.⁷

Our decision

We have considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 18 February 2021. We have considered and taken into account the

⁶ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

⁷ <https://www.gasgovernance.co.uk/sites/default/files/ggf/2021-03/Minutes%20and%20Determinations%20Panel%20Meeting%20269%20v2.0.pdf>

responses to the industry consultation on the modification proposal which are attached to the FMR⁸. We have concluded that:

- implementation of the modification proposal would not better facilitate the achievement of the Relevant Objectives of the UNC.⁹
- directing that the modification be made would not be consistent with our principal objective and statutory duties.¹⁰

Reasons for our decision

We consider this modification proposal would not better facilitate UNC Relevant Code Objective (d) and UNC Charging Methodology Relevant Objectives (**CMROs**) (c) and (aa). Given the similarities between UNC Relevant Code Objective (d) and the CMROs (c) and (aa), 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 states that UNC739 will have a positive impact on UNC Relevant Code Objective (d) because the introduction of an aggregate overrun regime will reintroduce the flexibility

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, see: <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.

that existed before 1 November 2015. The Proposer says that the Bacton split following the implementation of modification 501V resulted in a loss of flexibility for those shippers who had acquired entry capacity at the previously single Bacton ASEP.

The FMR refers to excerpts from our UNC501V decision. In that decision we said that:

"We recognise that existing Bacton capacity holders attach importance to the flexibility that they had as a result of both UKCS and interconnector flows entering the NTS at that point prior to Bacton being split. We also recognise that a mechanism to maintain this flexibility is not part of the proposal which we consider to best facilitate the relevant objectives, ie, UNC501V. [...] [W]e consider that there are existing market mechanisms¹¹ in the current UNC text which, when combined with the availability of substantial amounts of unused capacity at Bacton, minimise the downside of UNC501V not providing such a flexibility mechanism. [...]"

"However, we recognise the possibility that future UNC changes could remove these existing market mechanisms. If such changes to the UNC occurred, then there could be benefits for existing Bacton entry capacity holders and a furthering of effective competition between shippers from a flexibility mechanism similar to the one that is proposed under UNC501CV (whilst addressing our concerns with this proposal [...]). We therefore encourage industry to raise a further modification if they see a risk that future UNC changes would not allow for the existing market mechanisms to be used to flow flexibly at the current cost".

We consider that the changes implemented by UNC678A in October 2020 mean that the rationale for an aggregate overrun regime set out in our UNC501V decision are no longer applicable because of the protection given to existing contracts and the significant change from a primarily commodity-based charging regime to a capacity-based regime.

On 28 May 2020, we approved modification proposal UNC678A.¹² UNC678A introduced far-reaching reforms to the Great Britain (**GB**) transmission charging regime and ensured compliance with Commission Regulation (EU) 2017/460 of 16 March 2017 establishing a

¹¹ In footnote 19 of our UNC501V decision we said: "These other market mechanisms include the ability to buy capacity at zero reserve price auctions in the short-term timeframe, trade capacity on the secondary market or surrender capacity to NGG".

¹² 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>

network code on harmonised transmission tariff structures for gas (**TAR NC**).¹³ UNC678A implemented protections for “existing contracts” in accordance with Article 35(1) TAR NC which states that:

“This Regulation shall not affect the levels of transmission tariffs resulting from contracts or capacity bookings concluded before 6 April 2017 where such contracts or capacity bookings foresee no change in the levels of the capacity- and/or commodity-based transmission tariffs except for indexation, if any”.

The capacity holdings that UNC739 proposes to define as “Original Bacton Capacity” are existing contracts within the meaning of Article 35(1) TAR NC. It is our view that there is a tension between Article 35(1) TAR NC and other legislative requirements in TAR NC and the Gas Regulation¹⁴ regarding efficient competition. Following the implementation of UNC678A, existing contracts offer access to entry capacity for a significantly lower price than capacity which is not protected under Article 35(1) TAR NC and is subject to a floating price. According to NGG estimates, in Gas Year 2021/22, the average price for existing contracts will be 96% lower than the entry capacity reserve price for new capacity.¹⁵ At Bacton UKCS and Bacton IP, there are significant volumes of “Original Bacton Capacity” as shown below:

Table 1 – “Original Bacton Capacity” volumes (TWh) and values (£m) at Bacton UKCS and Bacton IP¹⁶

Original Contracts	Quantities (TWh)	Associated Revenues (£m)	Weighted Average Price ¹⁷ (p/kWh)
Bacton UKCS	374.298	32.866	0.00878
Bacton IP	47.592	4.076	0.00856

¹³ 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.

¹⁴ 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.

¹⁵ Source: <https://www.gasgovernance.co.uk/sites/default/files/ggf/2021-06/NTSCMF%20July%202021%20Open%20letter%20v1.0.pdf>

¹⁶ Table derived from capacity holdings starting on 1 October 2021

¹⁷ Ofgem estimates based on NGG data.

As shown in Table 1 above, the weighted average price of existing contracts at Bacton UKCS and Bacton IP is 0.00878 and 0.00856 p/kWh, respectively. This is 9.47% and 9.23% of the prevailing entry reserve price in Gas Year 2021/22 of 0.0927 p/kWh¹⁸.

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.

When we made the comments in our UNC501V decision referenced in the FMR, capacity charges were a small element of the overall transmission charge which was predominantly commodity-based and shippers who booked “original capacity” at Bacton had the reasonable expectation that they would pay a significant commodity charge if they chose to flow gas.¹⁹ Following the implementation of UNC678A, transmission charges are predominantly capacity-based, which has led to a significant monetary benefit for holders of existing contracts due to the removal of commodity charges. UNC739 would give holders of “original capacity” at Bacton significant benefits from enhanced flexibility in use of these existing contracts.

Under the UNC678A charging regime, approval of UNC739 would allow users of original capacity to use capacity flexibly across both Bacton UKCS and Bacton IP for less than one tenth of the prevailing price. This would exacerbate the problems caused by existing contracts further by increasing their economic value even more relative to “new” capacity. For these reasons, our comments in our UNC501V decision have been superseded by the subsequent transition to a predominantly capacity-based charging regime.

Panel noted that UNC739 may lead to “capacity displacement”, meaning that less “new” capacity may be acquired compared to what would be the case if UNC739 were not implemented. During the UNC consultation, respondents were asked to consider the following point: “Q1: Consider the risk of displacement of shorter-term capacity sales, extent and likely impacts on the consumer”. All three respondents noted that the proposed change carried some risk of capacity displacement. However, two argued that any negative effects would be outweighed by the benefits, claiming that more efficient capacity utilisation and increased

¹⁸ <https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2021-07/Notice%20of%20Gas%20Transportation%20Charges%20October%202021%20%281%29.pdf>

¹⁹ We note for instance that the last applicable TO entry commodity charge before the implementation of UNC678A on 1 October 2020 was set at 0.0491 p/kWh; see: <https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2020-02/Notice%20of%20Gas%20Transmission%20Transportation%20Charges%20Apr%202020%20R1.pdf>

flexibility would lower costs for consumers. Another argued that while costs for some users would be reduced through utilisation of existing contracts, a fall in new capacity sales could leave some users having to cover the cost of any resulting under-recovery. Ultimately, they stated that the impact of the proposal on prices is difficult to measure due to the unpredictability of shipper behaviour. Two respondents fully supported implementation of the modification and one offered qualified support.

Some Panel Members considered that UNC739 would not further facilitate UNC Relevant Objective (d) noting that “whilst implementation of this Modification would provide those holders of Original Bacton Capacity with the increased flexibility and likely utilisation of pre-November 2015 capacity, it will also likely result in lower sales of new capacity at the Bacton ASEPs. This may lead to impacts on Capacity Reserve prices for other Users”. We agree with this view.

We consider that UNC739 could lead to capacity displacement through fewer bookings of new capacity and more utilisation of existing contracts. This would be to the detriment of users of new capacity, as any revenue shortfall because of capacity displacement would lead to an increase in the price for new capacity.

While it is difficult to estimate the magnitude of the potential capacity displacement, we have considered various scenarios in Table 2 below. These scenarios consider the value of new capacity displaced that might result if unused capacity from Bacton UKCS were to be used at Bacton IP in periods of higher demand²⁰. While it is difficult to predict precisely the magnitude of any capacity displacement, we estimate that it could be a few million pounds per year if UNC739 were to be implemented. The 0.0927 p/kWh value is the reserve price for entry capacity for Gas Year 2021/22. The 0.0754 p/kWh value is the average published price over Gas Years 2021/22 to 2025/26 reflecting NGG’s published indicative prices.²¹

²⁰ We note that the opposite direction (Bacton IP original capacity being used at Bacton UKCS) is also possible under UNC739.

²¹ <https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2020-09/October%202020%20Transportation%20Statement.pdf>

Table 2 - Capacity displacement scenarios²²

Capacity Displacement Scenarios ²³ Monthly £m		Capacity price (p/kWh)	
		0.0927	0.0754
Capacity (GWh/d)	120	3.4	2.8
	140	4.0	3.3
	160	4.6	3.7

We consider that UNC739 have a negative impact on UNC Relevant Code Objective (d) and the CMROs (c) and (aa).

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. A Panel Member representing domestic consumers believed there would be capacity displacement therefore there is the risk of adverse effects on consumers. We agree with this view.

As shown above, UNC739 has the potential to lead to capacity displacement and fewer sales of new capacity. The significant price differential between existing contracts and new capacity provides a strong incentive for shippers to optimise their use of existing contracts across the two entry points and this overall is likely to lead to fewer new capacity sales and a higher price for new capacity. Furthermore, NGG's data shows that two shippers at each of the Bacton entry points hold the vast majority of "Original Bacton Capacity". Therefore, any benefits from approval of UNC739 will only benefit a few parties at the expense of other NTS parties and gas consumers across GB.

²² These scenarios are informed by the winter experience in Gas Year 2021/22. January saw a substantial demand for short-term capacity at the Bacton IP with under-utilisation of existing contracts capacity at Bacton UKCS. A repeat of this, associated with an implementation of UNC739, would imply substantial capacity displacement potential with illustrative values presented in Table 2 above against different capacity and pricing scenarios.

²³ The financial values in the Table are those associated with capacity displacement at stated levels over a full month. The Jan-Mar 21 data indicates average unused capacity at higher levels than reflected in the Table.

For these reasons, we consider that directing that the modification be made would not be consistent with our principal objective and statutory duties.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority has decided that modification proposal UNC 739: 'Aggregate overrun regime for Original Capacity held at the Bacton ASEPs' should not be made.

David O'Neill

Head of Gas Markets and Systems

Signed on behalf of the Authority and authorised for that purpose