IN THE MATTER OF THE EU NETWORK CODE ON HARMONISED TRANSMISSION TARIFF STRUCTURES FOR GAS (TAR NC)

FURTHER NOTE OF ADVICE

A. Introduction

1. I am asked to advise those instructing me as to whether or not SSE has good grounds to contend that any modification to the Gas Transmission Charging regime should take effect from 1 October 2019. The issue has arisen following Ofgem's consultation on the implementation of Commission Regulation (EU) 2017/460 of 16 March 2017 establishing a network code on harmonised transmission tariff structures for gas ('the TAR NC').[1] The GB domestic charging regime must comply with the relevant parts of the TAR NC by 31 May 2019.

2. I have previously advised on related matters concerning the proposed modification UNC 621 on 14 June 2018 and 4 March 2019. The question specifically arises in the light of proposed changes to Condition 25 for the Uniform Network Code ('UNC') made under proposal UNC 678. UNC 678 was raised by National Grid Gas ('NGG') on 17 January 2019.

3. In their legal text for Modification UNC 678, NGG has proposed an effective date of entry into force of the revised NTS Transportation Charging Methodology ('the Modification Effective Date') which is dependent on a Modification Direction Date. The Modification Direction Date is determined by the date on which the Gas and Electricity Markets Authority ('GEMA') gave the direction in question.

4. I understand that SSE believes that the amendments to the Transportation Charging Methodology should be brought into effect from the date of the next gas year, which

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[1] OJ [2017] L No. 72, 17.3.2017, p. 29.

would be 1 October 2019. The amendments proposed by NGG give GEMA an element of discretion to bring the changes into force on a date before or after 1 October 2019.

B. Relevant legal provisions

5. 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 and repealing Regulation (EC) No 1775/2005 ('the Gas Regulation')[2] introduced the entry/exit capacity charging system. It also *inter alia* sets out the criteria according to which tariffs for access to the network are determined, in order to ensure that they fully comply with the principle of non-discrimination and the needs of a well-functioning internal market.

6. Article 6 of the TAR NC requires an NRA to decide upon and set a reference price methodology ('RPM'). The procedure for doing so is prescribed by Articles 26 and 27. The application of the RPM shall then provide a reference price: Article 6(2). The same RPM is applied to *all* exit and entry points in a national transmission system: Article 6(3). This means that the RPM applied to Interconnection Points ('IPs') must be the same as that applied for internal network entry or exit points (or indeed third country IPs).

7. Article 29 TAR NC contains details of information that must be published *inter alia* in relation to standard capacity products prior to the annual yearly capacity auction. Pursuant to Article 32, this information must be published at least 30 days before the annual yearly capacity auction. Article 12(3) TAR NC states that the published prices shall be binding for the subsequent gas year.

8. Since Article 38(3) TAR NC states that Chapter II of the TAR NC shall apply from 31 May 2019, the UNC will have to reflect the modified charging methodology from that date.

9. However, other aspects of the TAR NC were brought into force from 1 October 2017. Chapters VI and VIII of the TAR NC came into force on that date. Chapter VI deals with the clearing price and payable price at IPs (and only IPs). Annual auctions for capacity at IPs had to be based on a floating price from 1 October 2017. Chapter VIII deals with

[2] OJ [2009] L No 211, 14.8.2009, p. 36.

publication requirements and relates to IPs and, where the national regulatory authority takes a decision to apply Regulation (EU) 2017/459 to points other than IPs, to other entry and exit points as well. This required certain information to be published a minimum period ahead of the yearly capacity auction set for IPs.

10. Commission Regulation (EU) No. 2017/459 of 16 March 2017 establishing a network code on capacity allocation mechanisms in gas transmission systems and repealing Regulation (EU) No 984/2013[3] ('the CAM Regulation') provides by Article 2(1) that it only applies to IPs (as defined in Article 3). However, it may also be applied to entry and exits points to and from third countries if a decision from the NRA is made to that effect.

11. Article 8 of the CAM Regulation requires that auctions shall be used for the allocation of capacity at IPs, except where an alternative allocation methodology under Article 30 is used. The remaining provisions of Article 8 set out the requirements for the auction process. Standard capacity products have to be offered in a logical order, with products covering yearly capacity being offered first. The availability of relevant standard capacity products has to be communicated in accordance with Articles 11 to 15 and according to the auction calendar (Article 8(5)).

12. In relation to standard capacity products, transmission system operators ('TSOs') are obliged to offer yearly, quarterly, monthly, daily and within day standard capacity products. Article 9(2) states:

    "Yearly standard capacity products shall be the capacity which may be applied for, in a given amount, by a network user for all gas days in a particular gas year (starting on 1 October)."

13. Pursuant to Article 11(1) of the CAM Regulation, yearly capacity auctions shall be held once a year. Article 11(4) requires those auctions from 2018 to start on the first Monday in July in each year, unless otherwise specified in the auction calendar. The CAM Regulation, pursuant to Article 40, came into force from 8 April 2017.

14. UNC General Terms, Section C, at [2.2(1)(e)] defines 'gas year' and 'capacity year' in the following terms:

[3] OJ [2017] L No 72, 17.3.2017, p. 1.

"(e) 'Gas Year' means the period from 1 October in any year until and including 30 September in the following year;
. . .
(h) 'Capacity Year' means the period from 1 October in any year until and including 30 September in the following year; . . ."

C. Analysis

15. I agree with those instructing me that the overall regime for standard product capacity auctions under the CAM Regulation envisages a gas year which commences on 1 October 2019. For reasons of regulatory and legal certainty, it would of course be strongly preferable for the transitional arrangements for the modified charging regime to synchronise with the period beginning on 1 October 2019.

16. The question I am asked in substance, however, is whether:
    16.1. There is a binding legal requirement under EU law for all of the modifications to come into effect on 1 October 2019; and
    16.2. If so, whether there is anything in the proposed terms of Clause 25 which would cut across this?

17. Taking the first issue first, Article 9(2) of the CAM Regulation clearly established a gas year for the purposes of yearly standard capacity products running from 1 October. The capacity which network users may therefore bid for will run from 1 October 2019 to 30 September 2020, since that is the next gas year. Pursuant to Article 11(4) of the CAM Regulation, the annual yearly capacity auction shall start on 1 July 2019 (being the first Monday in that month). That auction shall be used for the allocation of capacity at all IPs in the UK (Article 8(1) CAM Regulation). It need not, however, apply to other entry and exit points unless GEMA as the NRA takes a decision that it should do so. I have not found a specific obligation in the CAM Regulation for the same auction arrangements to be rolled out for non-IP capacity.

18. The TAR NC is concerned with setting a common RPM for transmission charging rather than for allocation by auction of capacity. It is true that, absent certain (irrelevant) exceptions, the same RPM should be used for all entry and exit points from the transmission system, be they IPs or not: Article 6(3) TAR NC. But I do not immediately

see how this must necessarily be read back into the capacity auction requirements established by the CAM Regulation. To do so would run counter to the discretion vested in NRAs by virtue of Article 2(1) of the CAM Regulation.

19. It is true that Article 32 TAR NC requires information concerning reserve prices to be published at least 30 days before 1 July 2019. Those reserve prices must then be applicable until at least 30 September 2020. Those reserve prices are determined on the basis of the reference prices set by Article 6(2) TAR NC: see Article 12(1) TAR NC. The publication of those reserve prices is accordingly binding for the subsequent gas year beginning after the annual yearly capacity auction: Article 12(3) TAR NC. By parity of reasoning, the reserve prices that were set for the auction in October 2018 remain binding until 30 September 2019.

20. As matters stand, therefore, the interaction of the TAR NC and the CAM Regulation produces the following obligations for GEMA by way of a time-line from today's date:

    20.1. From 31 May 2019, the reference price must be calculated in accordance with the new RPM.
    20.2. At least 30 days before 1 July 2019, GEMA must publish the relevant information, including the reserve prices (which are the reference prices) for the purposes of the annual yearly capacity auction.
    20.3. The annual yearly capacity auction must start on 1 July 2019.
    20.4. The results of that auction will apply from 1 October 2019.

21. There is a risk of incompatibility between the RPM and capacity regimes if GEMA were to seek to rely upon reference prices established under the old RPM and then they produced binding effects on the auction procedure for the gas year from October 2019. There would be a strong argument then that the binding effect of TAR NC had not been recognised in the subsequent operation of the auction capacity market. The practical impact of the above is that the reference prices under the new RPM will have to be published for the October 2019 auction on 31 May 2019 or 1 June 2019. Publishing any later would fail to give effect to the 30 day period of notice ahead of the start of the auction. The informational requirements include the reserve price, derived from the reference price. And the reference price must be based on the new methodology.

22. The terms of Clause 25 of the proposed modification must therefore permit the new RPM to become effective by no later than 1 June.

23. It is then necessary to consider exactly what Clause 25 envisages. The proposed legal text submitted by NGG does not specify a particular commencement date for the new provisions. Rather, it establishes a mechanism by which GEMA will give a modification direction and then a default Modification Effective Date unless GEMA's direction indicates to the contrary.

24. The default option is to consider the month in which the direction is given. If the direction is given in July 2019, for instance, the default position would be that the Modification Effective Date is 1 October 2019, being the first day of the third month following the month in which the Modification Direction Date falls. Given that the capacity auction is set to take place in July 2019, the default position is still capable of producing a Modification Effective Date of 1 October 2019.

25. However, in order to meet the other obligations set out above, the Modification Direction will have to be given by 1 June 2019. If the direction takes place on that date, then the default position would be that the Modification Effective Date is 1 September 2019. That would accordingly change the charging tariffs during the course of a gas year – something which the CAM Regulation would appear to set its stall against. (Although it might be said that the historic reserve prices remained binding even if a new methodology for charging were introduced).

26. If GEMA does not wish the default position to apply, it can give a direction for a different date to apply for the Modification Effective Date, provided it is after the date on which the direction is given and *not earlier than* 1 October 2019. Clause 25 would therefore permit GEMA to disapply the default position and still remain compatible with the TAR NC and CAM Regulation by issuing a direction on 31 May 2019 with a Modification Effective Date from 1 October 2019. In addition, Clause 25.3.1 permits NGG to apply the new RPM in order to determine reserve prices and transmission service charges. That should remove the risk of any inconsistency while the auction time-line is followed.

27. I should add that Clause 25.1.3. of the proposed amendment appears to me to be catering for the New Methodology to apply for the purposes of determining reserve prices and transportation charges for the auctions in 2020 and beyond. It could only apply to the 2019 auction process if a Modification Direction Date took place before 1 June 2019 (being four months before 1 October 2019).

28. It follows that there are situations in which GEMA could, if it issued a Modification Direction *too soon*, jeopardise the integrity of the TAR NC and CAM Regulation regimes. It would also amount to a change in the reference prices (and therefore potentially the reserve prices, depending on how the mechanism operates for monthly, daily or intra-day charges) for the gas year ending 30 September 2019 which would arguably fall foul of the interlaced provisions of both regimes.

29. That said, it seems to me that there is no inherent reason either why the terms of Clause 25 could not be used to achieve an EU law compliant result, provided that the timetable set out in paragraph 20 above is followed. If GEMA issued a Modification Direction which did not comply with this time-line, then it could be challenged as being in breach of EU law and producing results which ran counter to the EU law regimes. It would then be incumbent on GEMA (or a Court or Tribunal) to revoke that direction and for GEMA to issue another, compliant one.

30. I should also add that, as drafted, there is a risk of the Modification Direction stipulating a date which was *too late* to achieve compliance with the above requirements. That would also put GEMA (and the UK) in breach of its obligations, since the next capacity auction for gas year 2019/20 would then be operated on the basis of an RPM which was non-compliant with the TAR NC. Again, remedial relief would have to be sought.

31. Given this position, and given the time-line which can be established tolerably clearly on the basis of the existing regimes as they stand, in my view there is much to be said for simply stipulating the dates – or range of dates – within which certain steps are to take place for the purposes of the transitional regime. After the transition has taken place, the wording of the UNC could replicate more closely the times and dates within which certain steps are to be taken as a matter of EU law. That would improve regulatory certainty. It would also amount to a better application of the general EU law principle of legal certainty.

32. As matters stand, however, it would be the inappropriate issue of a Modification Direction by GEMA which would breach EU law, rather than the terms of Clause 25 itself.

33. I am happy to advise further by telephone or in writing if those instructing me consider it would be helpful to do so.

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3 April 2019

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