

Modification proposal:	<b>Uniform Network Code (UNC) 738: Incremental NTS Entry Capacity Surrender</b>		
Decision:	The Authority <sup>1</sup> directs modification UNC738 not be made. <sup>2</sup>		
Target audience:	UNC Panel, Parties to the UNC and other interested parties		
Date of publication:	19 March 2021	Implementation date:	n/a

## Background

National Transmission System (NTS) entry capacity can be booked via the Planning and Advanced Reservation of Capacity Agreement (PARCA) process<sup>3</sup> or through capacity auctions. At quarterly NTS entry capacity (QSEC) auctions, National Grid Gas Transmission (NGGT) sells entry capacity for gas years Y+2 to Y+16, which can include incremental entry capacity. Where incremental entry capacity is released and allocated to users, user commitment charges are incurred.

Prior to the implementation of UNC678A<sup>4</sup> (Amendments to the Gas Charging Regime, Postage Stamp), a fixed capacity price applied to entry capacity bought at the QSEC auctions. These contracts were subject to a floating commodity charge which recovered the majority of allowed Transmission Owner (TO) revenues.

On 1 October 2020, UNC678A was implemented. Under UNC678A transmission services revenue<sup>5</sup> is recovered through capacity charges. Also, capacity bookings are subject to a floating price, with the exception of certain fixed-price capacity bookings and contracts registered prior to 6 April 2017 which are classified as “existing contracts” in accordance with the Tariff Network Code (TAR NC).<sup>6</sup>

<sup>1</sup> 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.

<sup>2</sup> This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986

<sup>3</sup> The PARCA process is outlined in Uniform Network Code (UNC), Transportation Principal Document, Section B, 1.14.

<sup>4</sup> See our final decision on UNC678/A/B/C/D/E/F/G/H/I/J (28 May 2020) at: <https://www.ofgem.gov.uk/publications-and-updates/amendments-gas-transmission-charging-regime-decision-and-final-impact-assessment-unc678abcdefghij>

<sup>5</sup> “Transmission services revenue” means the part of the allowed or target revenue which is recovered by transmission tariffs.

<sup>6</sup> Article 35 of Commission Regulation (EU) 2017/460 of 16 March 2017 establishing a network code on harmonised transmission tariff structures for gas, now incorporated in UK law by the European Union (Withdrawal) Act 2018 and

## **The modification proposal**

Barrow Shipping Limited (“the proposer”) raised UNC738 (Incremental NTS Entry Capacity Surrender), which seeks to allow users to surrender non-obligated incremental NTS entry capacity allocated through bids at QSEC auctions from April 2017 to September 2020.<sup>7</sup> The proposer says that bids for NTS entry capacity assessed in auctions during this period were assessed on the basis of published reserve prices, and that “shippers were able to develop bidding strategies designed to meet the entry capacity release requirements”.<sup>8</sup>

The proposer has raised this modification due to the changes from UNC678A where the prices to be paid for incremental capacity can be different to the prices that triggered incremental capacity being allocated, and as such the user commitment may increase. The proposer argues that bidding strategies may have been materially different if the eventual prices had been known, but still designed to ensure the necessary user commitment was demonstrated.

The modification proposes that users are able to apply to NGGT to surrender incremental capacity that was allocated in the period from April 2017 to September 2020, and if NGGT accept, the user’s capacity holding would be reduced.

## **UNC Panel<sup>9</sup> recommendation**

At the UNC Panel meeting on 21 January 2021, the Panel unanimously did not recommend approval of UNC738.<sup>10</sup>

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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.

<sup>7</sup> 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-and-updates/uniform-network-code-unc-621abcdefghijkl-amendments-gas-transmission-charging-regime>

<sup>8</sup> See Final Modification Report (FMR) for UNC738 at: <https://www.gasgovernance.co.uk/sites/default/files/ggf/page/2021-01/Final%20Modification%20Report%200738%20v2.0%20.pdf>

<sup>9</sup> The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

<sup>10</sup> The discussions, representations and assessments made against the relevant objectives by panel members can be viewed in the FMR for UNC738 at: <https://www.gasgovernance.co.uk/sites/default/files/ggf/page/2021-01/Final%20Modification%20Report%200738%20v2.0%20.pdf>

## **Our decision**

We have considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 22 January 2021. We have considered and taken into account the responses to the industry consultation on the modification proposal which are attached to the FMR.<sup>11</sup> We have concluded that implementation of modification proposal UNC738 would not better facilitate the achievement of the relevant objectives of the UNC.<sup>12</sup>

## **Reasons for our decision**

We have considered the impact of the modification proposals against relevant objective (d) of the UNC. We consider that the other relevant objectives of the UNC are not relevant in the assessment of this modification.

### ***Relevant Objective 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.***

The proposer has raised this modification due to what it states was a “completely unexpected” scale of change to the pricing arrangement of entry capacity between 6 April 2017 and 30 September 2020 as a result of UNC678A. The proposer’s view is that “efficient allocation of NTS entry capacity supports users paying for the capacity they use, delivering cost reflectivity and so helping to secure effective competition”. As part of the industry consultation, a respondent supported the modification and claimed that the change to a floating price arrangement means the criteria for allocating capacity during this period may be “completely invalidated”, leading to a “distortion of the competitive environment”. The proposer and another respondent both stated that removing this uncertainty and distortion for new entry projects, and allowing parties to re-assess their capacity requirements by creating a window

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<sup>11</sup> UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at [www.gasgovernance.co.uk](http://www.gasgovernance.co.uk)

<sup>12</sup> 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>

for surrender of capacity would help to ensure efficient allocation of entry capacity supporting users paying for the capacity they use, delivering cost reflectivity and helping to secure effective competition.

One respondent commented that QSEC auction invitation letters sent out during this period signposted that fixed price charging arrangements for entry capacity registered between 6 April 2017 and 30 September 2020 were subject to review.<sup>13</sup> As we have previously stated, the TAR NC was published in the Official Journal of the European Union on 17 March 2017, and the GB gas sector had been aware of proposed changes and the need to implement the charging arrangements brought in by TAR NC.

TAR NC envisages floating prices for all contracts with the exception of fixed-price contracts entered into before 6 April 2017 (as “existing contracts” under Article 35 of TAR NC). In our decision on UNC621 we stated relevant parties “should have been aware of the effect of the changes to be introduced by TAR NC, and hence able to make allowance for the impending change in any contracts entered into after 6 April 2017. To the extent that users have entered into such contracts, they did so whilst being aware that the rules governing such contracts would change in line with known requirements, and that TAR NC only gives protection for contracts entered into before 6 April 2017”.<sup>14</sup>

In our decision on UNC501V<sup>15</sup> and repeated in UNC678A’s minded-to decision in respect of the “capacity surrender rule” we stated that “the introduction of a modification which includes hand-back would likely lead to increased costs for all shippers flowing gas onto the NTS because NGGT would have to recover the shortfall in payments that would otherwise have been obtained under existing capacity contracts. Further, we consider that it would be inappropriate to approve a modification that introduces rights that are not envisaged in the

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<sup>13</sup> Annual Invitation to Participate in Auction of Quarterly System Entry Capacity (QSEC) (20 February 2017): “For clarity, it should be noted that any capacity allocated in this auction shall not be subject to any protection afforded by Article 35 of the new EU Tariff Code”. Subsequent QSEC Invitation letters from 2019 and 2020 explicitly mentioned the implementation of TAR NC on 31 May 2019 and Ofgem decisions related to implementing its provisions in the GB gas regime, whilst highlighting the “potential for the payable prices associated with capacity allocated and commodity charges to be impacted by such modifications” [<https://www.gasgovernance.co.uk/APs/annual>].

<sup>14</sup> 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-and-updates/uniform-network-code-unc-621abcdefghijkl-amendments-gas-transmission-charging-regime>

<sup>15</sup> 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-and-updates/uniform-network-code-unc-0501v-unc501av-unc501bv-and-unc501cv-treatment-existing-entry-capacity-rights-bacton>

original capacity contracts, i.e., the ability to hand-back capacity. It is fair for existing capacity holders to be exposed to the risks associated with their decision to buy long term capacity”.<sup>16</sup>

We note that UNC738 attempts to introduce a mechanism that is very similar to the “capacity surrender” mechanism that we recently rejected as part of UNC678F. UNC738 does not appear to consider our previous decisions even though the comments we made there apply to this modification. Proposers, workgroups and the Panel should consider relevant Ofgem decisions when code modification proposals are raised as we take into account past decisions when making decisions on code modification proposals.

We consider that rather than removing uncertainty, capacity surrender would have a detrimental impact on competition, as the revenues associated with those capacity bookings would not flow to NGGT, but spread as costs across all other users, who would be cross-subsidising those who surrendered their capacity registered between April 2017 and September 2020. Whilst the quantity of capacity subject to this modification may be limited to non-obligated incremental, UNC738 introduces an option to allow certain users to flow gas with no ongoing obligation to pay capacity charges if they elect to surrender capacity, despite the capacity surrender rule not being an option in the original capacity contract and causing other users to pick up the costs. This is not an appropriate cross-subsidy and not in accordance with Ofgem’s principles for promoting effective competition and non-discrimination. This has a negative impact on the principles of competition and against relevant objective (d) of the UNC.

## **Decision notice**

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority has decided that modification proposal *UNC 738 'Incremental NTS Entry Capacity Surrender'* should not be made.

**David O’Neill**

**Head of Gas Markets and Systems**

Signed on behalf of the Authority and authorised for that purpose

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<sup>16</sup> Amendments to Gas Transmission Charging Regime: minded to decision and draft impact assessment (23 December 2019), page 52 available at: <https://www.ofgem.gov.uk/publications-and-updates/amendments-gas-transmission-charging-regime-minded-decision-and-draft-impact-assessment>