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Modification proposal:	**Uniform Network Code (UNC) 753: Removal of Pricing Disincentives for Secondary Trading of Fixed Price NTS System Entry Capacity (UNC753)**		
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:	26 November 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]

UNC678A introduced the Entry Transmission Services Revenue Recovery Charge (RRC). Under the UNC, National Grid Gas can apply an RRC to address over- or under-recovery of revenue.[5] The RRC applies to a User's Fully Adjusted Available NTS Entry Capacity, "excluding Existing Available Holding". UNC678A introduced the definition of 'Existing Available Holding' as NTS Entry Capacity held by a User as of 6 April 2017, the date TAR NC entered into force. NTS Entry Capacity held as of 6 April 2017 which has been allocated to a different User or traded

[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] Uniform Network Code Transportation Principal Document Section Y (Part A-I NTS Transportation Charging Methodology)

on secondary markets after 6 April 2017 ("secondary traded Existing Contracts") is not exempt from the RRC.

On 23 December 2020, we said that the use of RRCs should be avoided as they could undermine market confidence.[6] This remains our view.

The modification proposal

Total Gas & Power Ltd (the Proposer) raised UNC753: 'Removal of Pricing Disincentives for Secondary Trading of Fixed Price NTS System Entry Capacity'[7] proposing to introduce an exemption from RRCs for secondary traded Existing Contracts.

The Proposer states that the introduction of UNC678A means that there is a distortionary effect on the wholesale market and upstream gas supply chains because, unlike Existing Available Holdings, secondary traded Existing Contracts are not exempt from the RRC. They say this will result in a transfer of capacity back to the original holders to benefit from the Existing Available Holdings' RRC exemption and that this would be inefficient and unfair for Users who are unable to transfer secondary traded contracts to the original holders.

UNC753 proposes that secondary traded Existing Contract holdings transferred or assigned from a User with Existing Available Holdings to another User after the Tariff Regulation Effective Date, 6 April 2017, should be exempt from the RRC. For a secondary traded Existing Contract to be excluded from the RRC, a transfer would have to be notified as the transfer of an Existing Contract and relate to a whole quarter. Furthermore, the transfer must be between the User that holds the capacity as of 6 April 2017 and a recipient. Subsequent transfers of the secondary traded Existing Contracts would not be exempt from the RRC. Where Existing Contracts have been assigned after 6 April 2017, a new Existing Available Capacity Holding would be created for the assignee. If such an assignment has taken place prior to implementation of UNC753, the creation of Existing Available Capacity would take effect from the date of implementation.

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[6] See Open letter to National Grid Gas Transmission on Transmission Services Revenue Recovery Charges (23 December 2020) https://www.ofgem.gov.uk/publications/open-letter-national-grid-gas-transmission-transmission-services-revenue-recovery-charges
[7] https://www.gasgovernance.co.uk/0753

The Proposer says that this is intended to allow Users with Existing Available Holdings to transfer their Existing contract capacity to other Users without the recipients becoming liable for RRCs on that capacity. The proposal would also mean that capacity associated with Existing Available Holdings which has been assigned to Users after 6 April 2017 on withdrawal of the assignor from the Code would also not be liable for RRCs on that capacity.

UNC Panel[8] recommendation

At the UNC Panel meeting on 17 June 2021, 8 out of 13 members of the UNC Panel considered that UNC753 would not better facilitate the UNC objectives and the Panel therefore did not recommend its implementation. Among the panel members representing consumers, the Consumer Voting Member did not recommend implementation.[9] [10]

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.[11] We have concluded that:

- implementation of the modification proposal will not better facilitate the achievement of the relevant methodology objectives of the UNC.[12]

Reasons for our decision

We consider this modification proposal will not better facilitate UNC Relevant Objectives (c), (d), and (g), and UNC Charging Methodology Relevant Objectives (CRMOs) (c), and (e). Given

[8] The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.
[9] https://www.gasgovernance.co.uk/sites/default/files/ggf/2021-07/Determinations%20Record%20274%20v2.0.pdf
[10] The Non-domestic Consumer Voting Member was vacant.
[11] UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.co.uk
[12] 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

the similarities between the UNC Relevant Objectives and the CMROs, we assess them in tandem.

Objective (c) so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence

We consider that the proposal does not better facilitate UNC Relevant Objective (c).

The Proposer says that Users had a legitimate expectation of the protection of the ability to freely transfer long term fixed price capacity contracts. The Proposer says the ability to transfer long term fixed price capacity freely is a "vital right" and part of the risk management mechanisms available to Users who purchase long term fixed price capacity. Existing Contracts transferred or assigned after 6 April 2017 are not exempt from RRCs. The Proposer says that by extending the RRC exemption to Existing Contracts transferred or assigned after 6 April 2017, UNC753 would "remove arbitrary price differentials" and increase liquidity in the secondary capacity market.

Some consultation respondents and Panel Members said that UNC753 would result in more efficient capacity allocation by increasing liquidity in the secondary capacity market, better enabling intercompany arrangements between upstream and downstream entities, and avoiding the sterilisation of capacity. Some respondents agreed with the Proposer that Users had an expectation that long term fixed price contracts could be freely traded. In one response, a respondent said "Existing Contracts were purchased on the understanding that they could be traded as flexibly as the primary and secondary acquirer agreed between themselves".

Some Panel Members considered UNC753 to have no impact on UNC Relevant Objective (c) or no evidence of an impact. A Panel Member also said that capacity sold on secondary markets may be considered a new contract. One respondent said that "it is almost impossible to predict what the impact of this Modification would be" because "[t]he future level of the RRC is unknown and in addition it is impossible to know how much gas is being 'sleeved"'.

We consider that UNC753 does not better facilitate UNC Relevant Objective (c). The modification proposal does not provide enough evidence for an assessment of the impacts of UNC753 on the allocation of capacity other than Existing Contracts. However, other types of capacity make up a significant part of booked NTS capacity. Whilst we recognise that UNC753 may have the potential to increase liquidity in the secondary market for Existing Contracts, overall we consider that UNC753 would have an adverse impact on new capacity holders including further widening of the differences in treatment for new capacity and capacity purchased before 6 April 2017. We therefore conclude that UNC753 would not better facilitate the efficient discharge of the licensee’s obligations under this licence.

Objective (d) securing of effective competition and CMRO (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

We consider that UNC753 does not better facilitate and would have a negative impact on UNC Relevant Objective (d) and CMRO (c).

The Proposer says that UNC753 would better facilitate effective competition by reducing differences in the treatment of Existing Available Holdings and secondary traded Existing Contracts by making both exempt from RRCs. They say that the current difference in RRC treatment for Existing Available Holdings and secondary traded Existing Contracts amounts to discrimination. The Proposer also says that UNC753 would remove obstacles to new entrants by enabling them to benefit from the Existing Contracts’ RRC exemption.

Some Panel Members and Consultation Respondents said that UNC753 would have a negative impact on competition because by extending the protection from RRCs to secondary traded Existing Contracts, UNC753 would increase the difference in treatment for capacity purchased prior to 6 April 2017 and capacity bought after 6 April 2017 (“new capacity”). Members said this is because UNC753 would extend protection of Existing Contracts beyond those who originally entered into long-term capacity commitments before the Tariff Regulation Effective Date, and because if an RRC is set to recover part of Allowed Revenue, the relevant amount would be recovered over a diminished pool of Entry capacity.

We consider that UNC753 would have a negative impact on effective competition. While our position is that the use of RRCs should be avoided,[13] nevertheless UNC753 would extend an element of the protection offered to Existing Available Holdings to secondary traded Existing Contracts. This would benefit Users with Existing Available Holdings and those with access to secondary traded Existing Contract markets at the detriment of Users of new capacity which would continue to be liable for any RRC and may face higher charges as a positive RRC would be recovered over a diminished pool of holdings. Therefore, while UNC753 may reduce differences between the treatment of Existing Available Holdings and secondary traded Existing Contracts, it would increase the differences between the treatment of Existing Contracts and new capacity. On balance, we consider that UNC753 would exacerbate rather than alleviate the problems caused by Existing Contracts as it would effectively expand the scope of the capacity bookings that are exempt from the RRC to include secondary traded Existing Contracts.

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 (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 UNC753 does not better facilitate UNC Relevant Objective (g) or CMRO (e).

The Proposer refers to Article 7 of TAR NC which states (among other things) that the reference price methodology shall aim at "ensuring non-discrimination and prevent undue cross-subsidisation".

The Proposer also refers to Article 1 of the Gas Regulation[14] which states (among other things) that the Gas Regulation aims at "setting non-discriminatory rules for access conditions to natural gas transmission systems taking into account the special characteristics of national and regional markets with a view to ensuring the proper functioning of the internal market in

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[13] See Open letter to National Grid Gas Transmission on Transmission Services Revenue Recovery Charges (23 December 2020) https://www.ofgem.gov.uk/publications/open-letter-national-grid-gas-transmission-transmission-services-revenue-recovery-charges
[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.

gas;" and Article 13 of the Gas Regulation which requires (among other things) that tariffs shall:

- (i) be applied in a non-discriminatory manner;
- (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 argues that as a result of the protection granted to Existing Available Holdings, secondary traded Existing Contracts transferred or assigned after 6 April 2017 are exposed to RRCs, which results in discriminatory treatment of users of the same product on the basis of the date on which it is transferred or assigned to a different User. They refer 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". The Proposer says that this is inconsistent with Article 7 of TAR NC, Article 13 of the Gas Regulation, and aligns with the view expressed by ACER. In our UNC678A decision,[15] we said that proposals that exempt all Existing Contracts except those that have been secondary traded from the application of RRCs better facilitate compliance with Article 35 of TAR NC and we noted that "TAR NC is silent on the treatment of assigned Existing Contracts".

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. For this reason, the scope of contracts benefiting from protections offered to Existing Contracts should be construed narrowly. The solution proposed by UNC753 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" in the application of RRCs to include Existing Available Holdings transferred or assigned after 6 April 2017. This would be at odds with the legislative provisions mentioned above.

Decision notice

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[15] Amendments to Gas Transmission Charging Regime: Decision and Final Impact Assessment (UNC678/A/B/C/D/E/F/G/H/I/J) – Page 9 (28 May 2020) https://www.ofgem.gov.uk/publications/amendments-gas-transmission-charging-regime-decision-and-final-impact-assessment-unc678abcdefghij

In accordance with Standard Special Condition A11 of the Gas Transporters licence, the Authority has decided that modification proposal UNC 753: 'Removal of Pricing Disincentives for Secondary Trading of Fixed Price NTS System Entry Capacity' should not be made.

Eleanor Warburton

Deputy Director - ESO and Gas Systems

Signed on behalf of the Authority and authorised for that purpose