IN THE MATTER OF:

THE UK TARIFF NETWORK CODE ("UK TAR NC")

MODIFICATION UNC 0790 (Urgent)

INTRODUCTION OF A TRANSMISSION SERVICES ENTRY FLOW CHARGE

OPINION

A. INTRODUCTION AND SUMMARY OF ADVICE

1. I am asked by Eni Global Energy Markets SpA ("Eni") whether the proposed introduction by National Grid Gas Plc ("National Grid") of a Transmission Services Entry Flow Charge ("the Entry Flow Charge") as set out in Modification UNC 0790 (Urgent) ("the Modification") is compatible with the UK TAR NC[1] and whether there are any other legal issues which arise for consideration.

2. In my opinion, for the reasons set out below, if the Modification were given effect, it would more likely than not be held to be:

    - in breach of Article 4(3)(b) by calculating under-recovery on an *ex ante* basis; and
    - in breach of Article 17(1)(a) by contravening the principle against under- or over-recovery of revenue;
    - thus giving grounds for appeal under section 173 Energy Act 2004 or for a claim for judicial review; and further,

[1] The UK TAR NC is set out in Commission Regulation (EU) 2017/460 of 16 March 2017, OJ 2017 L 72/29, 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 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 (none of the amendments in Schedule 5 apply to the provisions cited in this Opinion). References herein to Articles are to the UK TAR NC, as amended, unless otherwise indicated.

- the Entry Flow Charge levied in accordance with the Modification may also be an abuse of a dominant position by National Grid through the imposition of an unfairly high price, contrary to section 18 of the Competition Act 1998 ("the Chapter II prohibition"), for which injunctive relief and/or damages could be available, as well as providing a ground for appeal or for judicial review.

B. ANALYSIS

UK TAR NC

3. As a starting point, it should be noted that there is no relevant jurisprudence at either EU or UK level on the interpretation of the UK TAR NC, which therefore falls to be interpreted in accordance with its terms under normal principles of construction applicable to EU derived legislation.

4. Article 4 is headed "Transmission and non-transmission services and tariffs".

5. Article 4(3) sets out as a basic principle that "The transmission services revenue shall be recovered by capacity-based transmission tariffs."[2]

6. Article 4(3) then goes on to set out exceptions to this general principle in paragraphs (a) and (b). It is a accepted principle of construction that exceptions to a general principle are to be interpreted strictly and thus not to be given a broad construction.[3]

7. National Grid relies upon the exception in Article 4(3)(b). This exception provides:

> As an exception, subject to the approval of the national regulatory authority, a part of the transmission services revenue may be recovered only by the following commodity-based transmission tariffs which are set separately from each other:
>
> …

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[2] "Transmission services" is defined by Article 3(12) to mean "the regulated services that are provided by the transmission system operator within the entry-exit system for the purposes of transmission", i.e. National Grid's regulated services in issue here.

[3] As the European Court of Justice has emphasised, "exceptions are to be interpreted strictly so that general rules are not negated". See Case C-346/08 *Commission v United Kingdom* [2010] ECR I-03491, [39] "In accordance with settled case-law, exceptions are to be interpreted strictly so that general rules are not negated (see, to this effect, Case C-476/01 *Kapper* [2004] ECR I-5205, paragraph 72)." See, by way of recent illustration in relation to exceptions to the general principle of public access to documents, judgments of 18 December 2007, *Sweden v Commission*, C-64/05 P, EU:C:2007:802, [66], and of 21 July 2011, *Sweden v MyTravel and Commission*, C-506/08 P, EU:C:2011:496, [75].

(b) a complementary revenue recovery charge, which shall comply with all of the following criteria:

(i) levied for the purpose of managing revenue under- and over-recovery;

(ii) calculated on the basis of forecasted or historical capacity allocations and flows, or both;

(iii) applied at points other than interconnection points;

(iv) applied after the national regulatory authority has made an assessment of its cost-reflectivity and its impact on cross-subsidisation between interconnection points and points other than interconnection points.

8. Chapter IV of the UK TAR NC is headed "Reconciliation of revenue". Article 17(1) provides that:

> Where and to the extent that the transmission operator functions under a non-price cap regime, the following principles shall apply:
>
> (a) the under- or over-recovery of the transmission services revenue shall be minimised having due regard to necessary investments ...

9. There is therefore a principle under the UK TAR NC against under- or over-recovery of revenue.

10. Revenue under- and over- recovery is defined in Article 18:

> 1. The under- or over-recovery of the transmission services revenue shall be equal to:
>
> $R_A - R$
>
> Where:
>
> R_A is the actually obtained revenue related to the provision of transmission services;
>
> R is the transmission services revenue. The values of R_A and R shall be attributed to the same tariff period and,
>
> where an effective inter-transmission system operator compensation mechanism referred to in Article 10(3) is established, shall take such mechanism into account.
>
> 2. Where the difference calculated in accordance with paragraph 1 is positive, it shall indicate an over-recovery of the transmission services revenue. Where such difference is negative, it shall indicate an under-recovery of the transmission services revenue.

11. Article 18 specifically refers to R_A as being "the actually obtained revenue". This means that it is revenue calculated on an *ex post facto* basis.

12. Article 4(3)(b) thus enables and requires flow-based charges to be adjusted on an *ex post facto* basis for any under- or over-recoveries arising from discrepancies between forecasts and outcomes, to allow for the fact that forecasts are rarely completely borne

out in practice. It is clear from the wording of Article 4(3)(b) – "which shall comply with all of the following criteria" – that the *ex post facto* basis is a mandatory requirement which cannot be disregarded.

13. However, this is not what National Grid has proposed in the Modification. National Grid's Modification instead proposes calculating under-recovery on an *ex ante* basis. In my opinion, this is in breach of the UK TAR NC,

14. The proposal presented by National Grid aims at artificially creating an *ex ante* expected under-recovery which will never materialise in practice. Specifically, in order to create this artificial *ex ante* under-recovery, National Grid proposes to calculate the Entry Capacity Reference Price in an abstract way, without taking into consideration the presence of Existing Contracts' fixed tariffs (and the related revenues) when calculating the Entry Capacity Reference Price.[4]

15. This is set out in the Modification at page 20 under the heading "Transmission Services Entry Capacity Reference Price"

> It is proposed that the determination of the Transmission Services Entry Capacity Reference Price for a Gas Year (in principle, the quantity of entry revenue to be collected (£) over this period divided by the quantity of entry capacity (kWh) expected to be booked over this period) is revised as follows:

Component	Current Method	Proposed Method
Quantity of Revenue (£)	Transmission Services Allowed Revenue at Entry *minus revenue from Existing Contracts*	Transmission Services Allowed Revenue at Entry
Quantity of Capacity (kWh)	Current Forecast Contracted Capacity (Entry) *minus Existing Contract capacity*	Proposed Forecast Contracted Capacity (Entry)

16. National Grid is therefore proposing to include Existing Contracts' capacity and revenues in the calculation of the capacity reserve price. This is what it advised against doing when it proposed the current methodology.

17. It stated in UNC 0678: Amendments to Gas Transmission Charging Regime at ¶3.39:

> The alternative approach of inclusion of capacity already booked and revenue levels already 'set' via Existing Contracts in the CWD RPM effectively 'double counts' any capacity and revenue for the relevant Entry Points and would have the consequence of setting Reference Prices at Entry Points too low to recover

[4] Existing Contracts are defined by Article 35, broadly, as those concluded before 6th April 2017.

> the target revenue. Inclusion of these elements in the CWD RPM would therefore be inconsistent, and arguably non-compliant, with Article 17.[5]

18. Ofgem has also stated that:

> We consider that excluding the capacity and revenue from Existing Contracts from the calculation of the reference price is more appropriate than including them. This is because the revenue to be recovered from Existing Contracts is already known and fixed at the time of the reference price calculation.[6]

19. National Grid's current proposal in the Modification is therefore, on its own analysis, arguably non-compliant with Article 17.

20. Indeed, I would go further. In my opinion, if the Modification were given effect, it would more likely than not to be held to be in breach of the UK TAR NC by:

    (i) calculating under-recovery on an *ex ante* basis in breach of Article 4(3)(b); and

    (ii) contravening the principle against under- or over-recovery of revenue under Article 17(1)(a).

21. Breach of the UK TAR NC in these ways would be a ground for appeal under section 173 Energy Act 2004 or for a claim for judicial review.

Chapter II prohibition under the Competition Act 1998

22. Recital 10 of the UK TAR NC makes it clear that:

> This Regulation should be without prejudice to application of Union and national competition rules, in particular the prohibitions of restrictive agreements (Article 101 of the Treaty on the Functioning of the European Union) and of abuse of a dominant position (Article 102 of the Treaty on the Functioning of the European Union). The harmonised transmission tariff structures put in place should be designed in such a way as to avoid foreclosure of downstream supply markets.

23. The UK national competition rules equivalent to Articles 101 and 102 TFEU are set out in the Competition Act 1998. In particular, the prohibition of abuse of dominance

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5 Version 4.0, 21st March 2021.:

https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2019-03/Modification%200678%20v4.0%20%28Change%20Marked%20from%20v3.0%29.pdf

6 UNC678/A/B/C/D/E/F/G/H/I/J: Amendments to Gas Transmission Charging Regime: minded to decision and draft impact assessment, 23rd December 2019, ¶4.49.

https://www.ofgem.gov.uk/publications/amendments-gas-transmission-charging-regime-minded-decision-and-draft-impact-assessment

in the UK or any part of the UK is imposed by the Chapter II prohibition under section 18 of the 1998 Act.

24. Section 18 provides:

> (1) … any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom.
>
> (2) Conduct may, in particular, constitute such an abuse if it consists in —
>
> (a) directly, or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
>
> (b) limiting production, markets or technical development to the prejudice of consumers;
>
> (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
>
> (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of the contracts.
>
> (3) In this section —
>
> "dominant position" means a dominant position within the United Kingdom; and
>
> "the United Kingdom" means the United Kingdom or any part of it.
>
> (4) The prohibition imposed by subsection (1) is referred to in this Act as "the Chapter II prohibition".

25. National Grid states that it "runs a natural near-monopoly of the British high-pressure transmission pipeline network".[7] The European Commission has consistently considered each gas transmission network to constitute a separate relevant product market.[8] It therefore follows that National Grid is in a dominant position in the UK for the purposes of the Chapter II prohibition.

26. Non-exhaustive categories of abuse are set out in section 18(2). These include in section 18(2)(a) directly or indirectly imposing unfair purchase prices or other unfair trading conditions.

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[7] National Grid, End-to-end balancing guide, November 2017, page 5.

https://www.nationalgrid.com/sites/default/files/documents/End%20to%20End%20Balancing%20Guide.pdf

[8] European Commission decision AT.40335 *Romanian Gas Interconnectors* [2021] 4 CMLR 11, [15]-[17]. Post-Brexit, European Commission decisions are still a relevant source of interpretative authority under the Chapter II prohibition pursuant to section 60A of the 1998 Act.

27. It is plainly arguable that creating an *ex ante* expected under-recovery which will never materialise in practice, and which will have the result of pushing prices higher, is the abuse of directly or indirectly imposing an unfairly high purchase price.

28. In the leading case on the abuse of unfair pricing, *United Brands*, the European Court of Justice held that the question was:

> "whether the difference between the costs actually incurred and the price actually charged is excessive, and, if the answer to this question is in the affirmative, whether a price has been imposed which is either unfair in itself or when compared to competing products."[9]

29. This is arguably the case here because National Grid proposes creating an *ex ante* under-recovery which will never materialise in practice, which must lead to a price which is excessive as it does not reflect costs actually incurred. This in turn could be said to be unfair in itself, as demonstrated by the fact that National Grid had previously argued against such an approach. And there is no need to consider other competing products, as there are none because National Grid has a natural near-monopoly,

30. I would also place reliance on *Der Grüne Punkt – Duales System Deutschland ("DSD")*[10] in establishing this head of abuse. The facts of *DSD* were as follows. DSD imposed contractual restrictions within a trade mark agreement (requiring application of the Green Dot recycling mark to all packaging used by the customer regardless of whether the customer actually used DSD for recycling) that led to customers being forced to pay for services they did not use.[11] The price was "clearly disproportionate" to the costs of providing the service given that part of the service was simply not being used.[12] There was no way for customers to avoid paying the higher price since it was not economically viable for customers to engage in selective labelling of their packaging with a view to part of their packaging requirements falling outside the DSD recycling service.[13] DSD therefore forced customers through unfair contractual terms to pay for unused services.

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9 Case 27/76 *United Brands* EU:C:1978:22, [252].

10 Commission Decision 2001/463/EC of 20 April 2001 relating to a proceeding pursuant to Article 82 [EC] (Case COMP D3/34493 – DSD), OJ 2001 L 166/1. Upheld on appeal in Case T-151/01, EU:T: and Case C-385/07 P, EU:C:2009:456.

11 Commission Decision, recitals 102 and 111; Case T-151/01 [48] and [119].

12 Commission Decision, recital 111; Case T-151/01 [48], [119] and [121].

13 Commission Decision recitals 102-108; Case T-151/01, [48].

31. In addition to a finding of unfair prices, the contractual terms in DSD constituted unfair trading terms on the basis they were disproportionate in the sense that DSD had "no reasonable interest" in linking the price charged not to the extent to which the service was actually used by customers but rather to the extent to which customers applied the Green Dot on their packaging for recycling.[14]

32. In *DSD*, it was thus held abusive to charge customers for a service they did not use and abusive to impose trading terms that in effect forced customers to pay for the unused services. The abusive price was linked to the abusive trading terms.

33. More recently, in *Preventx v Royal Mail*[15], on an application for an interim injunction, the High Court held that the introduction by the Post Office of a requirement that for prepaid returns of medical testing kits, its Tracked service must be used instead of its cheaper Freepost Standard service, although Preventx had no requirement for a tracked service, was arguably an exploitative abuse of dominance. As with *DSD,* the abuse lay in charging more than was necessary and was sufficiently arguable to justify interim injunctive relief.

34. Finally, in this regard, I also note that the UK's Competition Appeal Tribunal has recently certified two collective proceedings orders brought on behalf of consumers (rail users in southern England) alleging abuse of dominance by train operators through double-charging for certain rail fares. The Tribunal rejected the proposed defendants' application to strike out as unsustainable in law the claims of abuse.[16] In particular, the Tribunal placed reliance on the *DSD* infringement decision.

35. Certification thus means that the allegations of abuse through unfair pricing in both claims are fit to proceed to trial.

36. The *DSD* infringement decision appears to me to be analogous to the present case where the issue is artificially creating an *ex ante* expected under-recovery which will never materialise in practice. Therefore, Eni (and other shippers in the same position) would be required to pay the Entry Flow Charge for which there is no justification in fact.

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14 Commission Decision, recital 112.

15 [2020] EWHC 2276 (Ch), Roth J.

16 *Gutmann v South West Trains/London and South Eastern Railway* [2021] CAT 31, [51]-[75].

37. As well as providing a further ground for appeal or for judicial review, in addition to the Articles 4(3)(b) and 17(1)(a) issues, this would also provide a ground for Eni to seek injunctive relief against Ofgem and National Grid and/or damages against National Grid to recover over-payment, consequential losses and interest.

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3rd December 2021

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