

UNC Workgroup Report	At what stage is this document in the process?
<h1>UNC 0753:</h1> <h2>Removal of Pricing Disincentives for Secondary Trading of Fixed Price NTS System Entry Capacity</h2>	<div style="display: flex; flex-direction: column; gap: 5px;"> <div style="border: 1px solid #ccc; border-radius: 5px; padding: 5px; display: flex; align-items: center; gap: 5px;"> <span style="border: 1px solid #ccc; border-radius: 5px; padding: 2px 5px;">01</span> Modification         </div> <div style="border: 1px solid #ccc; border-radius: 5px; padding: 5px; display: flex; align-items: center; gap: 5px;"> <span style="border: 1px solid #ccc; border-radius: 5px; padding: 2px 5px;">02</span> Workgroup Report         </div> <div style="border: 1px solid #ccc; border-radius: 5px; padding: 5px; display: flex; align-items: center; gap: 5px;"> <span style="border: 1px solid #ccc; border-radius: 5px; padding: 2px 5px;">03</span> Draft Modification Report         </div> <div style="border: 1px solid #ccc; border-radius: 5px; padding: 5px; display: flex; align-items: center; gap: 5px;"> <span style="border: 1px solid #ccc; border-radius: 5px; padding: 2px 5px;">04</span> Final Modification Report         </div> </div>
<p><b>Purpose of Modification:</b></p> <p>To disapply the Entry Transmission Services Revenue Recovery Charge (RRC) from NTS Entry Capacity which a User acquires directly from another User in cases where that capacity forms part of that other User’s Existing Available Capacity thereby achieving compliance with UK and EU law.</p>	
	<p>The Workgroup recommends that this modification should not be subject to self-governance.</p> <p>The Panel will consider this Workgroup Report on 15 April 2021. The Panel will consider the recommendations and determine the appropriate next steps.</p>
	<p><b>High Impact:</b></p> <p>All parties that deliver or can deliver gas to NTS Entry Points and National Grid NTS.</p>
	<p><b>Medium Impact:</b></p> <p>N/A</p>
	<p><b>Low Impact:</b></p> <p>N/A</p>

Contents		?	Any questions?
1	Summary	3	Contact: Joint Office of Gas Transporters
2	Governance	4	 <a href="mailto:enquiries@gasgovernance.co.uk">enquiries@gasgovernance.co.uk</a>
3	Why Change?	7	 0121 288 2107
4	Code Specific Matters	12	Proposer: <b>Mark Simons</b> Total Gas & Power Ltd
5	Solution	13	 <a href="mailto:mark.simons@tgptrading.com">mark.simons@tgptrading.com</a>
6	Impacts & Other Considerations	15	 +41 79 323 28 24
7	Relevant Objectives	17	Transporter: <b>National Grid</b>
8	Implementation	22	Systems Provider: <b>Xoserve</b>
9	Legal Text	22	 <a href="mailto:commercial.enquiries@xoserve.com">commercial.enquiries@xoserve.com</a>
10	Recommendations	22	Other: <b>Nick Wye</b>
<b>Timetable</b>			 <a href="mailto:nick@waterswye.co.uk">nick@waterswye.co.uk</a>
<b>Modification timetable:</b>			 01789 266 811
Modification sent to Ofgem	29 January 2021		
Ofgem Decision on Urgency (rejection)	09 February 2021		
Initial consideration by Workgroup	02 March 2021		
Workgroup report presented to Panel	15 April 2021		
Draft Modification Report issued for consultation	16 April 2021		
Consultation Close-out for representations	07 May 2021		
Final Modification Report available for Panel	14 May 2021		
Modification Panel decision	20 May 2021		

## 1 Summary

Please note links to all external documents referenced in this Modification Proposal are in Section 4.

### What

This Modification proposes to disapply the Entry Transmission Services Revenue Recovery Charge (RRC) from NTS Entry Capacity which a User acquires directly from another User in cases where that capacity forms part of that other User's Existing Available Capacity.

### Why

The implementation of Modification 0678A on 01 October 2020 introduced a new Entry Transmission Services Revenue Recovery Charge (RRC). The charge applies to a User's "Fully Adjusted Available NTS Entry Capacity, Excluding Existing Available Holding". RRC does not apply to a User's Existing Available Holding, that is to say NTS Entry Capacity held by the User as of 06 April 2017, the date on which *Commission Regulation (EU) 2017/460 establishing a network code on harmonised transmission tariff structures for gas* (EU TAR or EU Tariff Code) entered into force (the Tariff Regulation Effective Date) - in effect long term fixed price NTS Entry Capacity or "Existing Contracts". As a result, a differential has been created between the charges for fixed price NTS Entry Capacity allocated to, or acquired on the secondary capacity market, by 06 April 2017, and identical fixed price NTS Entry Capacity which a User acquires through the secondary capacity market after that date. The distinction is arbitrary, distorts competition between Users and has no legal, regulatory or economic justification. As well as addressing the arbitrary and distortionary nature of the RRC as currently applied, the change is needed to rectify non-compliance with UK and EU legislation, in particular, Article 22 of *Regulation (EC) No 715/2009 on conditions for access to the natural gas transmission networks*. The breach of the Regulation (EC) No. 715/2009 is flagrant when it comes to Existing Contracts which are assigned to a User on the withdrawal of the User from the Code and originally allocated the capacity.

Unsurprisingly, the dual pricing regime for Existing Contracts, depending on whether or not they are traded on the secondary capacity market after 05 April 2017, is having a distortionary effect on the wholesale market and upstream gas supply chains, protecting incumbents and imposing disproportionately high costs on new entrants. Users are responding to this discriminatory pricing regime by using less efficient gas delivery arrangements mechanisms, relying on incumbents who booked long term capacity prior to 2017 instead of acquiring capacity from them or, where they can, transferring the capacity back to them. The result is that there will be a flow of transfers of capacity back to the original holders resulting in an outcome which is inefficient and unfair – higher RRC costs for Users who are unable, directly or indirectly, to take advantage of Existing Contracts. Those disadvantaged Users include Users who have received transfers of Existing Contracts after 05 April 2017 from a User that has subsequently withdrawn from the Code, in the case of an internal corporate reorganisation for example, or an insolvency of the original capacity holder. Gas transmission pricing should not arbitrarily impose penalties on Users thereby undermining the normal operations of a market.

### How

Instead of applying the RRC to a User's Fully Adjusted Available NTS Entry Capacity, Excluding Existing Available Holding for a Day and ASEP, it will be applied to a User's Fully Adjusted Available NTS Entry Capacity for a Day and ASEP adjusted by any transfer of Quarterly NTS Entry Capacity (QSEC) after the Tariff Regulation Effective Date. To be effective, the transfer must be notified as the transfer of an Existing

Contract and relate to a whole quarter. Any such transfer may not, cumulatively with all previous such transfers made by the transferor, exceed the level of the transferor's Existing Available Holding with respect to the ASEP on any Day within the quarter. In simple terms, this means that the transferor cannot transfer a greater volume of Existing Contracts than it holds, though it will not be possible to disaggregate blocks of quarterly capacity so as to transfer them in the form of new products covering shorter periods. Existing Contracts will maintain their integrity as quarterly products, consistent with the product sold originally and as classified as Existing Contracts in accordance with the Code definition.

The effect is that a User with fixed price NTS Entry Capacity as at the Tariff Regulation Effective Date (including as a result of a transfer to the User prior to that date) will be able to transfer that Existing Contract to another User without that other User becoming liable for RRC which the transferor would not have been liable for had the transfer not taken place. In the interests of solving the most egregious problems caused by the current dual charging regime as quickly as possible, a more comprehensive solution, whereby Users which acquire Existing Contracts after 05 April 2017 would be able to trade that capacity onwards free of RRC, has not been proposed. That is a second order issue with more significant system implications which can be separately addressed in a more leisurely manner.

Transitional Rules will address capacity transfers which have taken place prior to the Modification's implementation date.

Where an assignment of Existing Available Capacity took place after 05 April 2017 (on withdrawal of the assignor from the Code) a new Existing Available Capacity Holding will be created for the assignee (or its then Existing Available Holding shall be increased appropriately). Where such assignments have taken place prior to the implementation date of the Modification, the adjustment to, or creation of, the assignee's Existing Capacity Holding shall take effect from the implementation.

## 2 Governance

### Justification for Urgency

This Modification should be treated as an Urgent Modification and should proceed under a timetable approved by the Authority. A proposed timeline is provided in the timetable section of this Modification.

Urgent status is sought on the basis that, as it stands, the Code's provisions as regards RRC place the Transporter in breach of legal requirements, as discussed in section 4 below. Ofgem's guidance on the criteria it uses to determine Urgency include a current issue that if not urgently addressed may cause a person to be in breach of legal requirements. That is particularly the case when that person is the Transporter whose actions affect all other Users. The breach must be more than minor, and its impact significant: a further criterion is that the Modification Proposal addresses an issue that has a significant commercial impact on parties, consumers or other stakeholders. Both of these criteria are satisfied as indicated in Section 3, the breach of legal requirement is flagrant as regards legislation and licence requirements specifically governing gas transportation, and given National Grid's monopoly on gas transmission, wider competition law is also engaged.

The key points identified in Sections 3, 4 and 7 concerning legal compliance are as follows:

Ofgem's decision to implement UNC678A was partly based on the grounds that Article 35 had nothing to say about "assigned Existing Contracts", yet the EU Tariff Code should be read in the context of the Regulation (EC) No 715/2009 Article 22 which requires the contracts and Capacity bookings addressed by Article 35 to be freely tradeable on the secondary capacity market. Existing contracts are, or should be,

inherently assignable/transferrable without any vitiation of the entitlement that they constitute due to the imposition of an additional RRC charge by the transmission system operator.

The discrimination against new entrants (and others) who can only acquire Existing Contracts by transfers after the Tariff Regulation Effective Date contravenes one of the key aims of Regulation (EC) No 715/2009, as described in Article 1, of “setting non-discriminatory rules for access conditions to natural gas transmission systems”. It also contravenes Article 13 of Regulation (EC) No 715/2009 and thereby Article 7 of the EU Tariff Code in a variety of respects. The dual regime for RRC on Existing Contracts, as applied by the UNC following the implementation of UNC678A:

- is not applied in a non-discriminatory manner;
- does not facilitate efficient gas trade and competition;
- restricts market liquidity in capacity rights.

Finally, as a result of the contraventions stated above, National Grid Gas is in breach of Standard Special Condition A6 of its gas transporter’s licence which requires National Grid Gas “to conduct its transportation business in the manner best calculated to secure that ... [no] gas shipper or gas supplier ... obtains any unfair commercial advantage including, in particular, any such advantage from a preferential or discriminatory arrangement”.

The impact of this non-compliance has a material adverse effect on a wide number of shippers as set out in Sections 3 and 7, Moreover, as explained in Section 6, the current non-compliance can be expected to have an adverse impact on consumers, particularly those connected to the NTS.

The key points raised in this Modification relating to the impacts on shippers are as follows:

The current structure of transportation charges, in particular the application of RRC, has resulted in Users preferring to sleeve gas through Existing Contract User holdings rather than transfer it to the User who wishes to deliver gas to the NTS, thereby bypassing the application of the RRC. In some cases, this is not possible, for example:

- where the holder of the Existing Contract is no longer a User, for example, in the case where a User has undergone a company restructure and transferred capacity to an alternative corporate entity while “closing down” the entity which bought the Existing Contract.
- capacity was acquired by a third party on behalf of an infrastructure owner, such as storage or LNG, on behalf of the customers of that infrastructure facility. Due to confidentiality restrictions, the Existing Capacity procured by the third party must be transferred to the customer of the facility owner as it is unable to offer sleeving services
- where the Existing Capacity formed part of a wider transaction, including for example, the acquisition of offshore gas fields. As with the first bullet, the ability to transfer back the Existing Capacity to the original purchaser is wholly dependent upon the continued existence of the acquiring User, or even the willingness/ability of that User to accept responsibility for managing the delivery of gas onto the NTS and subsequent trading of gas at the NBP.

Data provided by National Grid NTS in its 12 January 2021 webinar<sup>1</sup> shows on slides 23 and 24 the impact of Existing Contracts on collected revenues. Ignoring the impact of Capacity Neutrality, which has been remedied from 01 January 2021 following implementation of UNC 0748, the volume of sales of “new” capacity between October and December has been lower than forecast, while the amount of revenue recovered has been significantly below National Grid’s expectations (around a 45% shortfall during October and November). The reasons for this are likely to be numerous, however, it is clear that a major contributor has been the market optimising the use of Existing Contracts and that this will increase from February 2021 when a positive RRC is to be applied.

Although the impact cannot be quantified in any precise terms, as the details concerning the volumes and prices of “sleeving” services are not publicly available, nor the volumes associated with scenarios set out above, it is clear that those Users holding Existing Contracts are able to profit not only from the differentials in the underlying cost of capacity, as between the Existing Contract price and the prevailing price, but also the cost of the RRC, which from 1 February 2021 will be set at 0.0294 p/kWh/day (0.86 p/therm/day). The imposition of the RRC on all but non-transferred Existing Contracts has created significant commercial advantages for some Users allowing significant premiums to be applied to the value of this capacity. Allied with the scenarios detailed above, where Users are unable to enter into secondary market arrangements to avoid RRC’s, there is a significant commercial disadvantage to Users not holding Existing Contracts created by the structure of the current charging regime.

For consumers, the impacts will depend on the terms of supply contracts and potentially direct impacts on the NBP price of gas where the marginal supply of gas is encumbered with the additional cost of the RRC. Where a consumer is subject to direct pass through of NTS costs, including entry costs, those consumers which are supplied with gas including RRC costs, it will be exposed to higher overall costs (0.0294 p/kWh/day) from 01 February 2021 as a result of the discriminatory application of the RRC.

If the Modification is not treated as Urgent, the uncertainty will lead to sub-optimal long-term transactions returning Existing Contracts to incumbents, hard-baking inefficiencies into the gas supply chain.

## **Justification for Authority Direction**

It is recommended that this Modification Proposal is sent to the Authority for Direction as it is necessary to rectify material inconsistency between the Code and relevant legal requirements and the Modification will have a material beneficial effect on commercial activities relating to the shipping, transportation and supply of gas. If implemented, it will substantially eradicate arbitrary and discriminatory inconsistencies between charges imposed on shippers which held long term capacity on 06 April 2017 (whether allocated or transferred to them as at that date) and Users that have received transfers of Existing Contracts or which wish to do so.

## **Requested Next Steps**

This Modification should be treated as Urgent and proceed under a timetable agreed with the Authority.

## **Ofgem Urgency Decision**

---

<sup>1</sup> <https://www.nationalgrid.com/uk/gas-transmission/document/134331/download>

Ofgem rejected the request for Urgency on 09 February 2021. Initial consideration by Workgroup was on 02 March 2021.

### 3 Why Change?

#### Background: Implementation of UNC 0678A

The RRC was implemented as part of Ofgem's approval of Modification Proposal UNC678A. Paragraph 3.23 of Modification Proposal 0678A states that RRC is "applied to the Fully Adjusted all capacity (at any points) [sic] apart from that classified as 'Existing Contracts' in order to give full effect to the provisions detailed in Article 35 of the EU Tariff Code". Paragraph 3.26 correctly describes Existing Contracts as "Entry Capacity (for 01 October 2019 or from the effective date of this Modification, whichever is later) allocated up to 06 April 2017." However, the solution proposed in section 5 of Modification Proposal 0678A is inconsistent with that description:

In respect of adjustments (including as a consequence of trades) to available Entry Capacity, where the adjustment is executed:

- up to and including 05 April 2017, the Capacity will be treated as Entry Capacity procured via Existing Contracts; or
- after 05 April 2017, the Capacity will not be treated as Entry Capacity procured via Existing Contracts.

This dual regime applying to capacity allocated by means of Existing Contracts, depending on whether the capacity has been transferred after 05 April 2017 or not, was introduced with the implementation of Modification 0678A.

Modification Proposal 0678A did not offer any explanation as to why Entry Capacity allocated prior to 05 April 2017 should be subject to different charges depending on whether it was transferred on the secondary capacity market before or after that Date. In its decision of 28 May 2020 to direct the implementation of Modification Proposal UNC 0678A, Ofgem considered the proposed exclusion from RRC for 'Existing Contracts' (within the meaning of Article 35, EU Tariff Code), concluding that the proposal "to exempt all Existing Contracts from the application of RRCs, is consistent with the operation of Article 35 TAR NC" (i.e. the EU Tariff Code). Ofgem considered that proposals with this feature "better facilitate compliance with Article 35 of EU Tariff Code than the other UNC678 proposals." As regards the proposed treatment of RRC by variant modifications, Ofgem concluded that in applying the new RRC to contracts falling within the scope of Article 35 of the EU Tariff Code they would "affect the levels of transmission tariffs" in respect of those contracts, contrary to the intention of the EU Tariff Code. But that also holds true for the application of RRC to Existing Contracts transferred on or after the Tariff Regulation Effective Date.

Ofgem noted that it had received comments both in support and against its assessment of exclusions from the RRC in response to its consultation on its Final Consultation on the Modification Proposals under Article 26(1) of the EU Tariff Code. Whether they proposed applying RRC to all Existing Contracts or opposed applying RRC to Existing Contracts (whether before or before or after secondary trading), a number of respondents to the consultation appear to have been concerned about the disparity of treatment between Existing Contracts retained by the User to which they were originally allocated, and those transferred on the secondary capacity market. For instance, Uniper is cited by Ofgem as supporting its interpretation of Article 35 of the EU Tariff Code yet stating that National Grid risks undermining Article 35 by applying RRCs to Existing Contracts that are traded between Users. ESB correctly observed that it is "unclear ... how

exemptions from RRCs for Existing Contracts do not also constitute a dual regime, which can impact on competition”. Storengy and GSOG argued that Existing Contracts traded on the secondary capacity market should not be subject to RRC and disagreed that UNC678A is compliant with the EU Tariff Code.

In response to these criticisms, Ofgem observed that none of the 11 UNC678 Modifications included an exemption from secondary traded Existing Contracts from RRC and no explanation had been given as to how a secondary trading system of Existing Contracts would operate in practice nor any proposal made for the underlying contractual terms that would govern it. It asserted that the EU Tariff Code “is silent on the treatment of “assigned Existing Contracts””. Ofgem also referred to the comments of Workgroup Participants in pages 35 and 36 of the Modification Report. These comments are inconclusive and there was no consensus amongst Workgroup members as to how, if at all, RRC should be applied to Existing Contracts. However, they observed that many Existing Contracts were in place as a result of well-established allocation arrangements for long term fixed price capacity and lamented that, as a result of National Grid’s delay in conducting a review of Existing Contracts as requested by Ofgem, there had been almost no opportunity to submit an amended Modification Proposal.

In the absence of any proposal that adequately addressed secondary trading of Existing Contracts, Ofgem concluded that the versions of the Modification Proposal 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 than those that do not.” Ultimately, it chose to implement UNC678A. This Modification Proposal rectifies the absence of a secondary trading system for Existing Contracts which Ofgem concluded was missing from the Modification 678A.

### **Commentary on relevant legislation**

Article 7 of the EU Tariff Code (or TAR NC) requires Reference Price Methodologies to aim at, amongst other things:

- compliance with Article 13 of Regulation (EC) No 715/2009;
- ensuring non-discrimination and prevent undue cross-subsidisation; and
- ensuring that the resulting reference prices do not distort cross-border trade.

Article 35 provides that the EU Tariff Code:

*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.*

Article 35 does not make any distinction between capacity bookings that have been transferred through secondary trading and capacity bookings that have not. Ofgem erred in stating that Article 35 is silent on the issue of “assigned Existing Contracts.” “Existing Contract” is the heading of the Article, which refers to Capacity bookings as well as contracts, and it is clear from Article 22 of Regulation (EC) No 715/2009 that bookings of Capacity, defined as “the maximum flow ... to which the network user is entitled in accordance with the provisions of a transport contract” should be transferable. The transfer of Capacity does not create a new Capacity booking; it is the assignment of an existing one. The reference to Existing Contracts and capacity bookings does not neglect to mention assignment (or transfer), it refers to such contracts and bookings whether they have been, or are to be, assigned (or transferred) or not.

As the EU Tariff Code is subsidiary legislation established under Article 6 of Regulation (EC) No 715/2009, it should be interpreted consistently with the Regulation and cannot override its terms. Article 13 of the

Regulation (EC) No 715/2009 imposes the following requirements with respect to Tariffs and the methodologies used to calculate them:

- they should be applied in a non-discriminatory manner;
- they should facilitate efficient gas trade and competition, while at the same time avoiding cross-subsidies between network users and providing incentives for investment; and
- they should neither restrict market liquidity nor distort trade across borders of different transmission systems.

Article 1 of the Regulation (EC) No 715/2009 sets out its three aims, the first of which is:

*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 gas.*

This objective includes “the setting of harmonised principles for tariffs, or the methodologies underlying their calculation, for access to the network ... and the facilitation of capacity trading.” In furtherance of that aim, Article 22 of the Regulation (EC) No 715/2009 provides as follows:

*Each transmission, storage and LNG system operator shall take reasonable steps to allow capacity rights to be freely tradable and to facilitate such trade in a transparent and non-discriminatory manner. Every such operator shall develop harmonised transport, LNG facility and storage contracts and procedures on the primary market to facilitate secondary trade of capacity and shall recognise the transfer of primary capacity rights where notified by system users.*

Article 27 of the EU Tariff Code requires the Agency for Cooperation of Energy Regulators (ACER) to analyse and respond to national regulators’ consultations on proposed reference price methodologies. In its final consultation, Ofgem stated that in GB there are a number of Entry Capacity contracts which fall under the EU Tariff Code definition of an Existing Contract. However, neither its description of Existing Contracts in Ofgem’s UNC0678 Minded to Decision and draft impact assessment at paragraphs 3.8 to 3.11, nor its discussion of RRC at paragraphs 4.17 to 4.26 (to which ACER refers) mention the transfer of such Existing Contracts or the decision taken in UNC0678A not to treat capacity allocated prior to the 06 April 2017 but transferred afterwards as an Existing Contract.

ACER’s response discusses the concept of discrimination, which it defines at paragraph 55 as “applying different rules to comparable situations or the same rule to different situations”. It recognises that “the dual regime that may arise out of the treatment of Existing Contracts could potentially be considered as discriminatory, since comparable capacities will face different tariff conditions.” However, on the basis of Baringa’s *Analysis of potential impacts of price differentials between new and existing capacity contracts* submitted by National Grid<sup>2</sup>, ACER concluded that “price differentials between new and existing capacity contracts will have a limited and transitory impact on consumer welfare, wholesale competition and broader gas market dynamics”. ACER summarises one of the three arguments cited by Baringa in favour of this conclusion as follows:

*Entry capacities are currently relatively overbooked (and this situation is supposed to last, since Ofgem assumes a declining use of the network in its Two Degree scenario). There will likely to be a secondary*

---

<sup>2</sup> <https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2019-04/Tariff%20differentials%20between%20new%20and%20existing%20contracts%20-%20Baringa%20report...pdf>

*market for capacity on the transmission network, where Existing Contract holders would have an incentive to sell excess capacity and new entrants may be able to purchase capacity at a tariff that is potentially lower than the tariff paid for Existing Contracts. However, it will remain necessary that existing capacity holders do not exercise any degree of market power by holding on to some unused capacity.*

### **Consequences of Modification UNC 0678A**

As a result of excess capacity bookings, capacity holders can be expected to sell capacity in the secondary capacity market, for a price that is potentially lower than the tariff they paid for the capacity under the Existing Contracts. However, this argument does not reflect the reality of the secondary capacity market for Existing Contracts following the implementation of Modification 0678A. As things have transpired, far from new entrants being able to purchase capacity at a tariff which is lower than that paid by the original capacity holders, new entrants face an additional tariff on such capacity because of their exposure to RRC for which the original capacity holder is not liable.

The reason for this discrepancy is that Baringa's analysis produced for National Grid does not in fact address the application of RRC to Existing Contracts transferred on or after the Tariff Regulation Effective Date. In section 2 of its analysis Baringa states that "holders of existing contracts should only expect to pay the capacity charges as defined in their contracts and face lower charges overall". Baringa's analysis is completely silent on the issue of transferred Existing Contracts, which do face a capacity-based revenue recovery charge as result of Modification 0678A. The dual pricing regime introduces a structural incentive into the transmission charging methodology for the holders of Existing Contracts to hang on to their capacity bolstering their market power in exactly the way that ACER feared.

ACER's assessment of the dual regime for capacity charges for existing and new capacity bookings is based on analysis submitted by National Grid Gas which inaccurately summarises RRC and its application to Existing Contracts. In the circumstances, ACER's recommendation at Paragraph 4 in section 1 of its report (ACER conclusion) is all the more pertinent:

*Ofgem should monitor the impact of the 'dual regime' that keeps existing capacity contracts unaffected by the new RPM. If detrimental effects were to be identified, Ofgem would have to implement remedies to ensure an appropriate level of wholesale market competition.*

At paragraph 63 in section 4.2.3 (Cross-subsidisation and discrimination) ACER goes further and encourages network users "to flag their situation to Ofgem in case the combination of tariff and market rules works at their detriment". The Proposer is doing just that with this Modification Proposal, though the problem arises not so much from the differential treatment of Existing Contracts and newly allocated capacity, which Baringa concludes on the basis of the information available to it (which does not appear to have include details of the treatment of transferred Existing Contracts) is unlikely to have a material or lasting impact on consumer welfare and broader gas market dynamics, as from the differential treatment of different, and arbitrary, categories of Existing Contracts.

The high level of RRC has led to a potentially disproportionate benefit for holders of Existing Contracts (whether the original capacity holder or a transferee that acquired the capacity prior to the Tariff Regulation Effective Date). Users that do not hold Existing Contracts as at that date are not only denied the benefit of the exclusion from RRC but, as Baringa observes with respect to new contract holders (i.e. those allocated capacity under the new tariff methodology), are exposed to additional costs as a result of the revenue shortfall. Two categories of Existing Contracts, which are not just comparable but identical, apart from the date on which a transfer (if any) of that Capacity occurred, will face different tariff conditions

Users are reported as seeking alternatives to using capacity transferred on or after the Tariff Regulation Effective Date. Rather than acquiring capacity from existing Capacity holders to enable them to deliver gas to the NTS, Users are arranging for the existing capacity holders to retain their Existing Contracts and deliver the gas to the NTS on their behalf (known as sleeving or beach/NBP swaps). Capacity acquired on or after the Tariff Regulation Effective Date is being transferred back to the original capacity holder, or to other Users that had entered into long term contracts and whose Existing Available Capacity is, as a result of subsequent transfers to third parties, lower than its current Available NTS Entry Capacity. Users whose Available NTS Entry Capacity has declined since the Tariff Regulation Effective Date are able to acquire capacity free of the RRC faced by Users who have increased their Available NTS Entry Capacity since that date.

The dual charging regime unpredictably impacts different Users in different ways depending on their individual circumstances. For instance, a User which acquired capacity from an affiliate which continues to operate as a shipper could reduce its exposure to RRC on NTS Entry Capacity by transferring the capacity back to its affiliate and receiving gas through trade nominations at the NBP, whereas a User which acquired capacity after the Tariff Regulation Effective Date from an affiliate which has since been wound up could not. A further advantage to Users holding long term fixed priced entry capacity on 06 April 2017 is that where they have transferred capacity to another User, reducing their Available NTS Entry Capacity below the level of their Existing Available Capacity, they can subsequently and legitimately acquire capacity, whether through capacity allocation or transfer, free of RRC, up until the point at which their Existing Available Capacity returns to the level of capacity they held on 06 April 2017. As a result, the discriminatory pricing in favour of holders of Existing Contracts as of 06 April 2017 can even apply to capacity awarded under the Charging Methodology introduced by Modification 0678A.

Other undesirable consequences occur where existing capacity is held by a User “on behalf” of an entry facility operator. Often sales contracts are entered into at, for example, storage or LNG facilities which include the provision of NTS Entry Capacity. When existing capacity is transferred as part of the bundle of capacity services the purchaser is subject to the RRC. In many cases, due to commercial confidentiality it is not possible for the holder of the entry capacity to “sleeve” gas through their existing capacity holdings; instead, capacity transfers are executed, which in turn exposes the transferee to RRC.

## Conclusions

Modification UNC678A’s introduction of a differential between charges levied for Existing Contracts depending on whether or not they were transferred after the Tariff Regulation Effective Date, is the result of a conceptual error. A Capacity Transfer does not create a new capacity contract – the original capacity holder remains liable for the Entry Capacity Charge. It is the transfer of an Existing Contract. Consequently, there would be no inconsistency with Article 35 of the EU Tariff Code in the exclusion of capacity allocated prior to the Tariff Regulation Effective Date from RRC irrespective of whether the capacity was transferred after that date. Ofgem’s decision to implement UNC678A was partly based on the grounds that Article 35 had nothing to say about “assigned Existing Contracts”, yet the EU Tariff Code should be read in the context of the Regulation (EC) No 715/2009 which requires the contracts and Capacity bookings addressed by Article 35 to be freely tradeable on the secondary capacity market. Existing contracts are, or should be, inherently assignable/transferable without any vitiation of the entitlement that they constitute due to the imposition of an additional RRC charge by the transmission system operator.

ACER’s assessment of the RRC is flawed in that it is based on an incomplete description. The summary of Modification 0678A in Ofgem’s Final Consultation under the EU Tariff Code discusses Existing Contracts but fails to mention the difference in treatment accorded to Existing Contracts transferred after 05 April 2017. Similarly, Baringa’s analysis, also considered by ACER, showed no recognition of the issue.

Irrespective of the uncertain legal status of ACER's recommendation, considering the detrimental effects that have arisen as a result of the arbitrary distinction drawn by UNC678A, Ofgem should take measures to rectify the error and address the resulting distortion of wholesale market competition.

### Impacts of the current arrangements

In terms of quantifying the impact, this is problematic as Users will be subject to different limitations depending on the status of the purchaser of the Existing Contract. As described above, the current structure of transportation charges, in particular the application of RRC, has resulted in Users preferring to sleeve gas through Existing Contract User holdings rather than transfer it to the User who wishes to deliver gas to the NTS, thereby bypassing the application of the RRC. In some cases, this is not possible, for example:

- where the holder of the Existing Contract is no longer a User, for example, in the case where a User has undergone a company restructure and transferred capacity to an alternative corporate entity while "closing down" the entity which bought the Existing Contract.
- capacity was acquired by a third party on behalf of an infrastructure owner, such as storage or LNG, on behalf of the customers of that infrastructure facility. Due to confidentiality restrictions, the Existing Capacity procured by the third party must be transferred to the customer of the facility owner as it is unable to offer sleeving services
- where the Existing Capacity formed part of a wider transaction, including for example, the acquisition of offshore gas fields. As with the first bullet, the ability to transfer back the Existing Capacity to the original purchaser is wholly dependent upon the continued existence of the acquiring User, or even the willingness/ability of that User to accept responsibility for managing the delivery of gas onto the NTS and subsequent trading of gas at the NBP.

Data provided by National Grid NTS in its 12 January 2021 webinar<sup>3</sup> shows on slides 23 and 24 the impact of Existing Contracts on collected revenues. Ignoring the impact of Capacity Neutrality, which has been remedied from 01 January 2021 following implementation of UNC 0748, the volume of sales of "new" capacity between October and December has been lower than forecast, while the amount of revenue recovered has been significantly below National Grid's expectations (around a 45% shortfall during October and November). The reasons for this are likely to be numerous, however, it is clear that a major contributor has been the market optimising the use of Existing Contracts and that this will increase from February 2021 when a positive RRC is to be applied. Looking forward, we anticipate that revenue under-recovery will continue to be experienced and that a further positive RRC will be applied from 01 October 2021.

## 4 Code Specific Matters

### Reference Documents

EU Tariff Code (Regulation 2017/460): <https://eur-lex.europa.eu/legalcontent/EN/TXT/?uri=CELEX:32017R0460>

Regulation (EC) No 715/2009 on conditions for access to the natural gas transmission networks  
<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02009R0715-20181224>

---

<sup>3</sup> <https://www.nationalgrid.com/uk/gas-transmission/document/134331/download>

UNC Modification Proposal 0678A: [https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2019-05/Part%20I%20of%20II%20Final%20Modification%20Report%200678%20v2.0\\_1.pdf](https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2019-05/Part%20I%20of%20II%20Final%20Modification%20Report%200678%20v2.0_1.pdf)

Ofgem decision: Amendments to Gas Transmission Charging Regime:  
UNC678/A/B/C/D/E/F/G/H/I/J: Amendments to Gas Transmission Charging Regime  
[https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2020-05/Ofgem%20Decision%20Letter%200678%20%28Urgent%29\\_0.pdf](https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2020-05/Ofgem%20Decision%20Letter%200678%20%28Urgent%29_0.pdf)

Ofgem minded to decision and draft impact assessment: UNC678/A/B/C/D/E/F/G/H/I/J: Amendments to Gas Transmission Charging Regime  
[https://www.ofgem.gov.uk/system/files/docs/2019/12/unc678\\_minded\\_to\\_decision.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/12/unc678_minded_to_decision.pdf)

ACER: Agency report - analysis of the consultation document for Great Britain  
[https://acer.europa.eu/Official\\_documents/Acts\\_of\\_the\\_Agency/Publication/Agency%20report%20-%20analysis%20of%20the%20consultation%20document%20for%20Great%20Britain.pdf](https://acer.europa.eu/Official_documents/Acts_of_the_Agency/Publication/Agency%20report%20-%20analysis%20of%20the%20consultation%20document%20for%20Great%20Britain.pdf)

Baringa: Analysis of potential impacts of price differentials between new and existing capacity contracts 01/04/2019 <https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2019-04/Tariff%20differentials%20between%20new%20and%20existing%20contracts%20-%20Baringa%20report..pdf>

## Knowledge/Skills

An understanding of Modification 0678A, UNC TPD Section Y Part A, and Sections B2.11 and B5 (Capacity Transfers), the EU Tariff Code, Gas Transmission Charging Review (GTCR) documentation and Competition Law would be beneficial.

## 5 Solution

The Entry RRC will be applied to a User's Fully Adjusted Available NTS Entry Capacity for a Day and Aggregate System Entry Point (ASEP) adjusted by any transfer of NTS Entry Capacity for that Day and ASEP after the Tariff Regulation Effective Date. For the transfer to be effective: :

- (i) it must be notified as a transfer of an Existing Contract;
- (ii) the capacity transferred must cover a whole calendar quarter and only one ASEP;
- (iii) the same amount of capacity must be transferred in respect of each Day in the quarter;
- (iv) cumulatively with all previous such transfers made by the transferor User, the transfer must not exceed the level of the transferor User's Existing Available Holding for that Day and ASEP.

Transfers of Existing Contracts will be recognised in the order in which they have been notified by both parties.

The effect is that a User which held long term QSEC as of 05 April 2017 may transfer that capacity to another User without that other User becoming liable for RRC which the transferor was not liable prior to the transfer. The recipient User would not, though, be able to trade that capacity on to another User on the same basis.

For the avoidance of doubt, each unit of QSEC Existing Capacity is discrete, meaning that the total amount of Existing Capacity held by a User which was acquired at the same time (e.g. the same auction) can be transferred in whole, or in part to a transferee(s).

Where an Existing Contract is transferred, both parties to the transfer must notify the Transporter of the Existing Contract transfer and the amount of capacity transferred, so that with effect from the effective date of the transfer a new Existing Available Holding is created for the transferee for the relevant quarter and the transferor's stock of Existing Contracts (its adjusted Existing Available Holding) for the period may be reduced accordingly. Any new Existing Available Holding would not be subject to RRC. Where an Existing Contract was transferred to User with an Existing Available Holding, RRC would not apply to the Existing Available Holding as adjusted by the additional QSEC.

It is not proposed to apply the Modification retrospectively, but where a transfer has taken place since the Tariff Regulation Effective Date but prior to the implementation date of the Modification, the transferor and transferee may notify the Transporter of the transfer and new and adjusted Existing Available Holdings for the relevant quarter will be created as appropriate with effect from the effective date of notification. To be effective such notice should be given within a specified time – within 30 days of the Modification implementation date. The transferor's and transferee's notifications of Existing Contract transfers must match to be effective and will be recognised in order of receipt. Where the prior capacity transfer related to the quarter in which the implementation date of the Modification occurs, the Existing Available Holdings of the transferor and transferee will be adjusted with effect from the date on which matching notifications of the Existing Contract transfer have been received from both of them. For example, if implementation occurs on 14 May, the quarter covering the period April – June, if transferred in accordance with the rules stated above, the period 15 May to 30 June will be included in the calculation of the User's Fully Adjusted Available NTS Entry Capacity (net of Existing Capacity transfers) where the transfer is notified on 15 May. Any notification of an Existing Contract transfer will be ineffective and rejected if the capacity transfer is rejected or if the transfer, if effective, would result in the transferor's Existing Available Holding on any day during the quarter to which the transfer relates being reduced below zero. Provisions relating to transfers of Existing Capacity which took place prior to the implementation date of the Modification should be dealt with in the Transition Document, Part IIC – Transitional Rules.

The process may be built into the existing capacity transfer process or established as a separate parallel process depending on which is easier to implement in terms of IT system changes. If the Existing Contract process was integrated with standard capacity transfer process then the rejection of the Existing Contract transfer would also cause a rejection of the standard capacity transfer process, but not if two separate processes were involved.

Where an assignment of Existing Available Capacity took place after 5 April 2017 (on withdrawal of the assignor from the Code) a new Existing Available Capacity Holding will be created for the assignee (or its then Existing Available Holding shall be increased appropriately). Where such assignments have taken place prior to the implementation date of the Modification, the adjustment to, or creation of, the assignee's Existing Capacity Holding shall take effect from the implementation. In such cases, the assignee must notify the Transporter of the Existing Contract assignment, the date of the assignment and the amount of capacity assigned, so that a new Existing Available Holding is created for the assignee for the relevant quarter at a date after the implementation of this Modification. The Transporter will check, based on their records, that the notified assignment is valid, reconciling the identity of the User, the volume assigned and the date of assignment. Where this is the case, the assignment will be accepted, otherwise it will be rejected and communicated to the User.

## 6 Impacts & Other Considerations

### Does this modification impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

No.

#### Consumer Impacts

##### The Proposer's view

The impact of the Modification would be to increase liquidity in the secondary capacity market, which can be expected to result in the more economically efficient allocation of capacity. It would also reduce arbitrary discrimination in favour of Users who held fixed price capacity as of 05 April 2017, compromising effective competition. The Modification would obviate the need for Users to adopt more expensive arrangements involving the engagement of the original capacity holders to ship gas to the NBP on their behalf, free of RRC that the Users would incur if they acquired the capacity from the incumbent. All these factors can be expected to increase the cost of gas to consumers where there is a direct impact on the NBP until long term fixed price capacity bookings expire, so their reduction or elimination as a result of this Modification will be a positive benefit to consumers.

By making it easier for Users to acquire Existing Contracts, exempt from RRC, the Modification may result in Users who do not hold or acquire such capacity being exposed to higher levels of RRC. However, the arrangements that many Users are adopting and will continue to adopt by engaging Users who held Existing Available Capacity to ship to the NBP on their behalf will have much the same effect. Consequently, this Modification's impact on the level of RRC for Users who do not hold or acquire Fixed Price Capacity is unlikely to have an appreciable impact on the costs associated with the RRC compared to the status quo.

Generally, the Proposer anticipates that there will be an immaterial impact on consumers on the understanding that consumer contracts are struck ex-NBP, noting that NTS Entry charges make an insignificant contribution to the overall cost of gas, however, where there are pass-throughs of NTS charges to certain, usually NTS connected consumers, the impacts will be significant.

##### Workgroup view

Workgroup Participants noted that analysis was not available in relation to quantification of the impact of this Modification. National Grid clarified that it is almost impossible to predict what the impact of this Modification would be. The future level of the RRC is unknown and in addition it is impossible to know how much gas is being 'sleeved'.

A Workgroup Participant believed there would be very little impact of the implementation of the Modification since the Modification allows for a more efficient operation of the system.

National Grid clarified that where the Modification enables some Users to not pay RRC (if there otherwise were to be an RRC payable), that RRC amount not paid will still need to be paid by another User.

## Consumer Impact Assessment

Criteria	Extent of Impact
Which Consumer groups are affected?	Direct positive effects will be felt by those very large consumers receiving gas directly from an Entry Point, where their Shipper is transferring Existing Capacity and paying the RRC. All consumers should indirectly benefit from more efficient trading in the market.
What costs or benefits will pass through to them?	Improved liquidity in the market should be of indirect benefit to consumers.
When will these costs/benefits impact upon consumers?	Upon implementation.
Are there any other Consumer Impacts?	None identified.
<b>General Market Assumptions as at December 2016 (to underpin the Costs analysis)</b>	
<i>Number of Domestic consumers</i>	<i>21 million</i>
<i>Number of non-domestic consumers &lt;73,200 kWh/annum</i>	<i>500,000</i>
<i>Number of consumers between 73,200 and 732,000 kWh/annum</i>	<i>250,000</i>
<i>Number of very large consumers &gt;732,000 kWh/annum</i>	<i>26,000</i>

### Cross Code Impacts

None identified.

### EU Code Impacts

EU Tariff Code compliance is considered as part of this Modification Proposal. Please see Section 7 Relevant Objectives.

Workgroup Participants noted that References to Regulation 715/2009 and EU TAR NC refer to law that is now part of retained GB law, as a result of the implementation of Modification 0735VS.

### Central Systems Impacts

There will be impacts on Gemini and UK Link invoicing systems, although the Proposer believes that a manual fix should be implemented before the full system solution can be delivered (this may require ex-post reconciliations).

Workgroup Participants briefly reviewed the ROM (XRN 5328) dated 12 March 2021 at the Workgroup on 12 April 2021. It was noted that a manual fix would be acceptable to the Proposer however the ROM is for an enduring solution. It is unclear whether a manual fix is available for this Modification.

### Rough Order of Magnitude (ROM) Assessment - XRN 5328<sup>4</sup>

Cost estimate from CDSP	£135,000-£175,000
High level timescale estimate	12-14 weeks

## 7 Relevant Objectives

Impact of the modification on the Relevant Objectives:

Relevant Objective	Identified impact
a) Efficient and economic operation of the pipe-line system.	None
b) Coordinated, efficient and economic operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters.	None
c) Efficient discharge of the licensee's obligations.	Positive
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.	Positive
e) Provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards... are satisfied as respects the availability of gas to their domestic customers.	None
f) Promotion of efficiency in the implementation and administration of the Code.	None
g) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.	Positive

Demonstration of how the Relevant Objectives are furthered:

**Proposer's view: Relevant Objective (c) Efficient discharge of the licensee's obligations**

<sup>4</sup> <https://www.gasgovernance.co.uk/0753>

Several Users who were allocated long term fixed price QSEC prior to the Tariff Regulation Effective Date benefit from Entry Capacity Charges that are proving to be lower than the price at which the same capacity can be acquired after that date. In some instances, they are paying higher Entry Capacity Charges than they would have done had they not acquired the capacity on a fixed price basis. That potential for reward, the management of the risk of future changes in price, and the risk of being unable to take advantage of future reductions in charges are inherent features in a User's choice to book long term capacity on a fixed price basis.

Users' legitimate expectation of the protection of their rights under long term contracts, with respect to capacity pricing, was recognised by Article 35 of the EU Tariff Code, which provides that the obligations it imposed on Transmission System Operators "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".

However, price is not the only risk management mechanism open to Users who buy long term fixed price capacity. The ability to transfer that capacity freely is also a vital right. If the User faces a failure in the supply route for gas that it had intended to import at the relevant entry point, it can cut its losses by selling the capacity to another User who has more need of it. The right is not expressly protected by the EU Tariff Code, but then nothing in the EU Tariff Code requires transporters or national regulators to take any steps that might infringe such a right. Indeed, that right endures under the Regulation (EC) No 715/2009 from which the EU Tariff Code derives: Article 22 provides that capacity should be freely assignable.

Modification Proposal 0678A was proposed and implemented in response to the EU Tariff Code. It nominally honoured fixed price Entry Capacity Charges, but it introduced a new charge, RRC. The RRC is a capacity charge, but one which, in contrast to Entry Capacity Charges, is payable by Users by reference to the amount of capacity they hold, having taken capacity transfers into account, rather than by the User originally allocated that capacity, irrespective of whether it has been transferred or not. In an attempt to avoid applying additional capacity charges to fixed price capacity, it was decided that RRC would not be applied to Users' capacity holdings as of 05 April 2017, the date on which the EU Tariff Code came into effect.

That decision created a problem. It had the effect of maintaining the fixed capacity charges for capacity held by the User to which it was originally allocated, and also for Users who acquired the capacity before 06 April 2017, but it subjected any User who acquired the capacity after that date to what is proving to be a substantial and volatile additional charge (the RRC). That capacity is not new capacity, but capacity identical in every respect to other fixed price capacity for the same Entry Point retained by the User to which it was originally granted, or which is transferred by that User prior to 06 April 2017.

By removing the distinction between fixed price QSEC capacity transferred after 05 April 2017 and fixed price QSEC which is not so transferred, this Modification Proposal would remove arbitrary price differentials applying to Users, with respect to both QSEC acquired before 06 April 2017 and even potentially QSEC awarded after April 2017 priced in accordance with the charging methodology adopted under Modification 0678A. By creating a more level playing field between holders of Existing Contracts and those who may wish to acquire the benefit of those Existing Contracts through a transfer, it better facilitates Standard Special Condition A6 of National Grid Gas' gas transporter's licence which requires National Grid Gas "to conduct its transportation business in the manner best calculated to secure that ... [no] gas shipper or gas supplier ... obtains any unfair commercial advantage including, in particular, any such advantage from a preferential or discriminatory arrangement".

Under paragraph Standard Special Condition A5: Obligations as Regard Charging Methodology National Grid Gas is required to keep the charging methodology at all times under review “for the purposes of ensuring that the charging methodology achieves the relevant methodology objectives”. These objectives include “compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or” ACER, and the charging methodology facilitating effective competition between gas shippers and between gas suppliers.

**Workgroup Participants response: Relevant Objective (c) Efficient discharge of the licensee's obligations**

A Workgroup Participant agreed with the Proposer that this Modification would positively impact Relevant Objective c).

Some Workgroup Participants did not feel this Modification has any impact, neither positive nor negative for Relevant Objective c).

Other Workgroup Participants noted that rights and obligations associated with Existing Contracts were originally sold with a right to pay a liability which no longer exists. However, they felt it was difficult to decide whether this Modification furthers Relevant Objective c) or not.

The nub of the issue is “what were the terms of the original contract?”.

**Proposer’s view: Relevant Objective (d) Securing of effective competition**

As observed by ACER in its review of the Modification 0678A, the application of “different rules to comparable situations” is the very essence of discrimination. The adverse impacts of this discrimination are discussed in this Modification Proposal in Section 3, *Why Change?*

**Workgroup Participants response: Relevant Objective (d) Securing of effective competition**

Some Workgroup Participants agreed with the Proposer that there were elements of the Modification Proposal which positively further Relevant Objective d).

**Proposer’s view: Relevant Objective (g) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.**

One of the grounds given by Ofgem for deciding to implement Modification 0678A was that neither UNC0678 nor any of the alternative Modification Proposals included an exemption from secondary traded Existing Contracts from RRC. As the versions of the Modification Proposal 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 than those that do not”, Ofgem reasoned that it should implement one of the alternatives that exempted Existing Contracts from RRC, (although not Existing Contracts which, when acquired by the transferee increase the transferee’s Available Entry Capacity above the level held by it, in relation to the relevant Entry Point and day, on the Tariff Regulation Effective Date), because none of the proposals presented addressed the transfer of Existing Contracts . However, the inadequacy of Modification Proposals presented to Ofgem is not a justification for the implementation of a tariff methodology which is non-compliant with both the EU Tariff Code and Regulation (EC) No 715/2009.

Although Ofgem states in both its EU Tariff Code consultation on the Modification Proposals and decision to implement that Modifications UNC678 and UNC678A are compliant with the EU Tariff Code and Regulation (EC) No 715/2009, Ofgem does not offer any explanation as to how it comes to that conclusion with respect to the RRC's compliance with the EU Tariff Code and gives no explanation at all as to why it believes the proposals comply with Regulation (EC) No 715/2009.

The application of RRC to Existing Contracts, or capacity bookings, transferred after the Tariff Regulation Effective Date falls squarely within ACER's definition of discrimination: "comparable capacities will face different tariff conditions". The RRC fails to aim at ensuring non-discrimination as required by Article 7 of the EU Tariff Code or preventing undue cross-subsidisation that may arise as a result. Further analysis would be required to determine whether it ensures that reference prices do not distort cross-border trade. ACER notes that Existing Contracts under the UNC "benefit from lower capacity prices and almost always concern domestic entry capacities", which suggests that the exclusion of Existing Contracts from RRC has the potential to distort cross-border trade. Whether the failure to exclude all Existing Contracts from RRC could do so is a different matter.

For the reasons stated above, the RRC, as implemented by UNC0678A, is non-compliant with the EU Tariff Code and Regulation (EC) No 715/2009, both of which are retained law under the European Union (Withdrawal) Act 2018, so, notwithstanding the expiry of the Brexit Transitional Period, remain in force as amended for the purposes of the UK by Regulations issued under that Act. (A fresh Modification Proposal is required to bring the UNC into line with the requirements of this retained EU legislation, this is expected to be brought forward by National Grid shortly).

The discrimination against new entrants (and others) who can only acquire Existing Contracts by transfers after the Tariff Regulation Effective Date contravenes one of the key aims of Regulation (EC) No 715/2009, as described in Article 1, of "setting non-discriminatory rules for access conditions to natural gas transmission systems". It also contravenes Article 13 of Regulation (EC) No 715/2009 and thereby Article 7 of the EU Tariff Code in a variety of respects. The dual regime for RRC on Existing Contracts, as applied by the UNC following the implementation of UNC678A:

- is not applied in a non-discriminatory manner;
- does not facilitate efficient gas trade and competition;
- restricts market liquidity in capacity rights.

In its review of the GB charging arrangements under Article 27 of the EU Tariff Code, ACER noted that "the dual regime that may arise out of the treatment of Existing Contracts could potentially be considered as discriminatory, since comparable capacities will face different tariff conditions." They are not just comparable capacities, but identical capacities, deriving, as they do, from the self-same Existing Contracts. The high level of RRC has resulted in the fulfilment of ACERs gloomy prognostications.

The imposition of an additional charge on transfers of Existing Contracts after the Tariff Regulation Effective Date in the form of RRC also contravenes Article 22 of the Regulation which requires the transmission system operator "to take reasonable steps to allow capacity rights to be freely tradable and to facilitate such trade in a transparent and non-discriminatory manner". Capacity which attracts a substantial additional charge as a result, which is out of all proportion to the resources required on National Grid Gas' part to process the transfer, can hardly be described as freely tradeable, even more so when the level of charge and the exposure to the risk of variations in RRC, which has proved to be both higher and more volatile than expected, inhibits transfers of Existing Contracts from the original holder altogether.

Although the proposed solution only addresses the initial transfer of Existing Available Holdings Contracts and does not aspire to be a complete solution to the obstacles to secondary trading of Existing Contracts, implementation of this Modification Proposal is wholly consistent with Article 22 of Regulation (EC) 715/2009. Pending development of the more complex systems changes that a complete solution would entail, the Transporter’s compliance with this proposed Modification would amount to the “reasonable steps” that Article 22 requires the Transporter to take in order to allow Existing Contracts “to be freely tradable and to facilitate such trade in a transparent and non-discriminatory manner”.

**Workgroup Participants response: Relevant Objective (g) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.**

Some Workgroup Participants believed that implementation of this Modification would ensure that the charging arrangements remain compliant, and this would further Relevant Objective g).

Impact of the modification on the Relevant Charging Methodology Objectives:	
Relevant Objective	Identified impact
a) Save in so far as paragraphs (aa) or (d) apply, that compliance with the charging methodology results in charges which reflect the costs incurred by the licensee in its transportation business;	None
aa) That, in so far as prices in respect of transportation arrangements are established by auction, either: <ul style="list-style-type: none"> <li>(i) no reserve price is applied, or</li> <li>(ii) that reserve price is set at a level -                             <ul style="list-style-type: none"> <li>(I) best calculated to promote efficiency and avoid undue preference in the supply of transportation services; and</li> <li>(II) best calculated to promote competition between gas suppliers and between gas shippers;</li> </ul> </li> </ul>	None
b) That, so far as is consistent with sub-paragraph (a), the charging methodology properly takes account of developments in the transportation business;	None
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	Positive
d) That the charging methodology reflects any alternative arrangements put in place in accordance with a determination made by the Secretary of State under paragraph 2A(a) of Standard Special Condition A27 (Disposal of Assets).	None
e) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.	Positive

Demonstration of how the Relevant Charging Objectives are furthered:

**Proposer’s view: Relevant 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**

The adverse impacts of the dual pricing regime for Existing Contracts are discussed in this Modification Proposal in Section 3, Why Change? The purpose of the proposed Modification is to enable new entrants

to benefit from Existing Contracts as well as the incumbents, by removing obstacles to the new entrants using the capacity (after a transfer on the same terms as the original holder). The elimination of such arbitrary discrimination is obviously going to result in more effective competition between shippers.

**Workgroup Participants response: Relevant 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**

Some Workgroup Participants agreed with the Proposer that there were elements of the Modification Proposal which positively further Charging Relevant Objective c).

**Proposer's view: Relevant Objective (e) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators**

See text provided above for (g) under standard Relevant Objectives.

**Workgroup Participants response: Relevant Objective (e) Compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators**

See text provided above for (g) under standard Relevant Objectives.

## 8 Implementation

No implementation timescales are proposed. However, implementation should be as soon as possible after an Authority direction to do so.

## 9 Legal Text

Legal Text and Legal Text Commentary has been provided by National Grid and is published alongside this report here: <https://www.gasgovernance.co.uk/0753> . Both the Proposer and the Workgroup have considered the Legal Text and are satisfied that it meets the intent of the Solution.

## 10 Recommendations

### Workgroup's Recommendation to Panel

The Workgroup asks Panel to agree that:

- This Modification should proceed to consultation.