

Modification proposal:	Uniform Network Code (UNC) 265: Creation of a NTS Capacity Retention¹ Charge within the Uniform Network Code		
Decision:	The Authority ² directs that this proposal be made ³		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	17 December 2009	Implementation Date:	With immediate effect

Background to the modification proposal

The Fourth Transmission Price Control Review (TPCR4) created an obligation on National Grid Gas (NGG) to undertake Entry Capacity Substitution (ECS) when proposing to release incremental capacity. ECS is the process by which unsold non-incremental obligated entry capacity⁴ is moved from one or more NTS entry points to meet the demand for incremental obligated entry capacity at another NTS entry point. Under the licence, NGG was required to develop and submit a methodology for substitution to the Authority for approval.

NGG submitted the ECS Methodology Statement and supporting documents to the Authority on 7 September 2009. We subsequently undertook an Impact Assessment, which assessed the Methodology against the entry capacity substitution objectives of the licence. We considered carefully all of the responses to that consultation in coming to our decision, and on 7 December 2009 we approved NGG's entry capacity substitution methodology.

The ECS methodology introduces a "retainer" as an annual product which can be taken out at any entry point with substitutable capacity. When it is requested ahead of the quarterly system entry capacity (QSEC) auction, it allows the volume of capacity identified by the retainer to be excluded from being treated as substitutable capacity during the QSEC or in any other quarterly system entry capacity auctions during the year. It does not create rights for the user to be allocated the capacity, nor does it withhold the capacity from being offered for sale at the QSEC or any other auction. Capacity rights can only be obtained at a QSEC in the normal way, in competition with other users. There is no limit to the number of retainers that can be purchased in sequential years.

A refund of the retainer cost to the initial user can be obtained if capacity is subsequently purchased by any user at any of the next three QSEC auctions, and also at AMSEC auctions, as detailed by the ECS methodology. This provides considerable flexibility for users. The retainer charges and the refund mechanism are set out in NGG's Gas Charging Methodology modification proposal GCM 018, which is subject to separate consideration.

¹ The term Retainer and Retention charge are used interchangeably in this document and reflect the terminology used in earlier documents during the development of the substitution methodology

² The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

³ This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

⁴ NGG's entry capacity release obligations are defined in its gas transporter licence. Non-incremental obligated entry capacity is the volume of baseline capacity which the licensee is required to offer for sale at an entry point.

The modification proposal

The proposal defines the NTS Entry Capacity Retention Charge as a Transportation Charge within the UNC and will allow NGG to invoice for (and refund) the revenue associated with the charge. Without the modification, revenues or refunds related to the retention charge would not be counted as allowed revenue and could not be charged or refunded.

With UNC 265 NGG propose inserting text into UNC TPD Section B – System Use and Capacity which lists NTS Entry Capacity Retention Charges as being one of the charges which comprise Transportation Charges⁵.

They also propose to insert text which states that NGG may, in accordance with the substitution methodology statement, invite users to retain capacity from substitution. The text also explains that the terms and conditions applicable to any retention arrangement will be specified in the substitution methodology statement⁶.

The proposer believes that the proposal would better facilitate the economic and efficient management of the network and promote the efficient discharge of their licence obligation.

UNC Panel⁷ recommendation

The UNC Panel met to consider the proposal on 15 October 2009.

The Panel discussed whether or not to defer consideration of the proposal⁸, as under the NTS methodologies current at the time, implementation would add redundant conditions⁹ into the UNC and hence implementation could not be expected to better facilitate achievement of the 'Code Relevant Objectives'. However, implementation would ensure that the UNC was consistent with proposed changes to the Transportation Charging Methodology, and that these changes could be implemented as part of the introduction of entry capacity substitution. This would therefore further the 'code relevant objective' of "the efficient discharge of the licensee's obligations under this licence" and "the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code". The Panel agreed to proceed to a recommendation in order to ensure that all substitution related decisions could be taken by Ofgem at the same time, and to ensure that the published timetable could be achieved.

Of the 10 voting members present capable of casting 10 votes, 5 were cast in favour of implementation. As a majority is required, the panel did not recommend the implementation of the proposal.

⁵ Para 1.7.1(a)(i) of the UNC TPD Section B – System Use and Capacity

⁶ 2.15 of TPD Section B – System Use and Capacity

⁷ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules

⁸ This had also been discussed at the September 2009 UNC panel meeting, which had voted to defer consideration of this proposal.

⁹ At the time of the UNC panel meeting Ofgem had yet not made a decision on NGG's entry capacity substitution methodology.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 15 October 2009. The Authority has considered and taken into account the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR¹⁰. The Authority is satisfied that:

- 1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC¹¹; and**
- 2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties¹².**

Reasons for the Authority's decision

The Joint Office consulted on the proposal between September and October 2009. They received seven responses, six of which supported the implementation of the proposal. However whilst respondents expressed their support for the modification proposal, those in favour of the implementation of UNC265 stated their support was for the modification in isolation, since the entry capacity substitution methodology was still under consideration by Ofgem at the time, and no decision to veto or approve the methodology had yet been made. The views reflected the fact that if the substitution methodology were approved and implemented, then UNC265 would be necessary so that Shippers are charged the correct amount for the retainer.

The proposer submits that the relevant objectives set out in sub-paragraphs (a) and (c) and (f) of Standard Special Condition A11.1 would be better facilitated by the proposed modification. We agree that these are the appropriate relevant objectives to consider and set out our views on these objectives below. As the proposal is limited to defining the retention charge in the UNC, the potential benefits are related to facilitating the implementation of substitution.

SSC A11.1 (a): the efficient and economic operation of the pipeline system

As set out in our decision letter of 7 December 2009 on the ECS methodology, implementation of UNC265 and the ECS methodology will allow for the substitution of capacity between ASEPs. This should lower the need for investment in the gas network when providing incremental entry capacity and, consequently, this will result in lower costs to consumers. This is consistent with better facilitating the achievement of objective (a).

SSC A11.1 (c): So far as consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations

¹⁰ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com

¹¹ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=6547

¹² The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

Implementation of UNC265 will facilitate the introduction of substitution and ensure both that the UNC properly reflects the full range of entry charges NGG can levy, and that revenue associated with the retainer is properly treated as allowed revenue. It will also ensure that NGG meets its licence obligation to implement substitution. Therefore, we consider that UNC265 better facilitates achievement of this objective.

One respondent to the consultation noted that UNC265 could have a detrimental effect on NGG's licence condition to not over recover entry revenue. We consider that given the small magnitude of the retention charge relative to the other Transmission Owner (TO) charges, it is unlikely that the impact of the retention charge will directly lead to a situation of TO over recovery. Also, currently, we note that there is under recovery of TO entry capacity revenues, and this is addressed via adjustments to the TO commodity charge. The retention charge allows Shippers to signal where they do not want capacity to be available for substitution. Where entry capacity that has been retained is subsequently sold at an auction, the retainer charges will be reimbursed to Shippers using the mechanisms that exist within the charging methodology to deal with such over recovery situations.

SSC A11.1 (f): So far as consistent with sub-paragraphs (a) to (e), promotion of efficiency in the implementation and administration of the network code and/or UNC

Implementation of UNC265 will ensure that the retention charge is recognised within the UNC as a transportation charge and is treated as allowed revenue. This alignment of the UNC and the ECS methodology will promote efficiency in the implementation of the UNC and therefore better facilitate this objective.

Conclusion

In summary we believe that the proposal, which defines the NTS Entry Capacity Retention Charge as a Transportation Charge within the UNC, supports the approved NGG entry capacity substitution methodology and will better facilitate the relevant objectives of the licence and is consistent with our principal objective and statutory duties.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority, hereby directs that modification proposal UNC 265: Creation of a NTS Capacity Retention Charge within the Uniform Network Code be made.

Stuart Cook
Acting Senior Partner, Transmission and Governance

Signed on behalf of the Authority and authorised for that purpose.