

Modification proposal:	<b>Uniform Network Code (UNC) 338V: Remove the UNC requirement for a 'gas trader' User to hold a Gas Shipper Licence (UNC 338V)</b>		
Decision:	The Authority <sup>1</sup> directs that this proposal be made <sup>2</sup>		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	12 October 2012	Implementation Date:	To be confirmed by the Joint Office

## Background

During 2010, we commenced a review of our licence application process. As part of this review, we noted a marked increase in gas shipper licence applications during 2009. We asked Xoserve<sup>3</sup> to provide us with details of parties that were using their systems for shipping and found that many licensees were not physically conveying gas. We attributed the increase in gas shipper licence applications to the requirement to hold a gas shipper licence in order to accede to the UNC and access the Gemini system.<sup>4</sup>

In June 2010, we launched a consultation on proposed changes to the Licence Application Regulations.<sup>5</sup> As part of this consultation we welcomed views on whether parties should be required to hold a gas shipper licence in order to be able to carry out gas trades and sign up to the UNC. The majority of respondents agreed that it was not appropriate to require parties to obtain a gas shipper licence prior to being able to carry out gas trades.

In January 2012, we published our open letter consultation on changes to Ofgem's licensing policy for Gas Traders.<sup>6</sup> We sought views on whether Gas Traders who are not involved in the activities prescribed by the Gas Act should be required to have a gas shipper licence.

In July 2012, we published our 'minded to' consultation on Ofgem's licensing policy for Gas Traders. We also set out that we were minded to approve related modification proposal UNC 338V<sup>7</sup> 'Remove the UNC requirement for a 'gas trader' User to hold a Gas Shipper Licence', setting out our views on the issues raised by respondents, and asking some additional questions in relation to the implementation date.<sup>8</sup>

<sup>1</sup> The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

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

<sup>3</sup> Xoserve manages the commercial interfaces between the major gas transporters operating in Great Britain and Gas Shippers.

<sup>4</sup> The Gemini system is managed and operated by xoserve and enables gas shippers to carry out gas nominations, energy balancing and exit capacity booking.

<sup>5</sup> 'Proposed changes to the current Application Regulations and Revocation Schedules of future licences', reference number 74/10. This consultation can be found at

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=App%20Regs%202010%20Consultation.pdf&refer=Licensing/Work>

<sup>6</sup> Please see <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?do cid=196&refer=LICENSING/WORK>

<sup>7</sup> This can be found at

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?do cid=233&refer=Licensing/Work>

<sup>8</sup> We received 4 responses to our 'Minded to' consultation, 3 in support and 1 not in support. We have published our final decision on the licensing consultation on our website:

<http://www.ofgem.gov.uk/Licensing/Work/Pages/Work.aspx>

## The modification proposal

The Uniform Network Code (UNC) currently requires a party, wishing to become a signatory to the UNC and trade gas, to hold a gas shipper licence and sign up to the Code as a Shipper User. However, some Shipper Users do not undertake activities that require a gas shipper licence to be held<sup>9</sup>. To address this issue, National Grid Gas Transmission (the Proposer) has raised modification proposal UNC338 (which has since become UNC338V).

This modification proposes to introduce a new type of User (a Trader User)<sup>10</sup> in order to distinguish between:

- 1) Users involved in the conveyance of gas, or arranging for the conveyance of gas, under the terms of the UNC (Shipper User); and,
- 2) Users not involved in the conveyance of gas, or arranging for the conveyance of gas under the terms of the UNC, but whose activities are directly related to the registration of Trade Nominations (Trader User).

The Trader User will be allowed to become a signatory to the UNC without holding a gas shipper licence. For the avoidance of doubt, Users who are involved in the physical conveyance of gas (Shipper Users) will not be allowed to sign up to the UNC without holding the relevant licence. Shippers will therefore continue to be responsible for ensuring that they hold the appropriate licence to undertake their activities, as prescribed by the Gas Act.

The modification proposes that the definition of 'User' within Section B of the General Terms shall incorporate the definition of Trader User (TU). Existing references to Users throughout the UNC shall therefore refer to TUs by default. In addition, the modification proposes that each UNC Section will clearly identify whether it applies to a TU or not. For example, Section B of the Transportation Principal Document (TPD)<sup>11</sup> describes 'Users' as entities that book capacity, but a TU will not have any rights and obligations under that Section; a new paragraph within the same Section B will indicate this. This approach is repeated for each Section of the UNC.

Given the nature of this change, we do not list all the Sections of the UNC which will be modified as a result of this proposal; however, we note a few important changes:

*TPD D - Operational Balancing and Trading Arrangements:* the modification proposes that TUs shall be able to post Non-Physical Market Transactions as the Originating Participant only and accept Non-Physical Market Transactions as the Accepting Participant. They will also be able to accept Physical Market Transactions as the Accepting Participant only, while they will not be allowed to post a Physical Market Transaction as an Originating Participant.

*TPD F - System Clearing, Balancing Charges and Neutrality:* as this Section describes the charges arising from any User incurring an imbalance, it will apply to TUs.

*TPD Q - Emergencies:* the modification proposes that TUs will be subject to this Section of the UNC, as any imbalance position they have built up could potentially contribute to

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<sup>9</sup> That is, activities that fall within the prohibition of unlicensed activities contained in the Gas Act 1986.

<sup>10</sup> Currently there are only 3 types of Users under the UNC: restricted User, DNO User and Shipper User.

<sup>11</sup> The TPD can be found on the Joint Office website at: <http://gasgovernance.co.uk/TPD>

an emergency. In particular, this modification will add paragraphs to ensure that TUs continue to be under an obligation to co-operate in emergency situations.

*TPD V – General:* this Section describes both the admission rules (Section V2) and the termination rules (Section V4), and these Sections will apply to TUs. This modification will also add paragraphs to ensure that TUs continue to be under an obligation not to act in a manner that jeopardises the efficient and safe operation of the system.

### **UNC Panel<sup>12</sup> recommendation**

At the Modification Panel meeting held on 19 April 2012, eight members voted against implementation and only one member voted in favour. Therefore the Panel did not recommend implementation. The views of the Panel are set out in full in the Final Modification Report (FMR) dated 19 April 2012.<sup>13</sup>

### **Consultation responses**

There were ten responses to the Joint Office consultation: six not in support, two in support (one of which offered qualified support) and two providing comments.

In July 2012, we published our own consultation on our 'minded to' position to accept UNC 338V. We received four responses to this consultation, three in support and one not in support.

### **The Authority's decision**

We have considered the issues raised by the modification proposal and the FMR dated 19 April 2012. We have considered and taken into account the responses to the Joint Office's consultation on the modification proposal, which are attached to the FMR, and responses to the 'minded to' consultation carried out by Ofgem. The Authority has concluded that:

1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC;<sup>14</sup> and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties.<sup>15</sup>

### **Reasons for the Authority's decision**

We have considered all the responses to both the Joint Office consultation and Ofgem's 'minded to' consultation and have assessed the proposed modification against the UNC Relevant Objectives. We consider this proposal would further objective d) and would be neutral with regard to the other Relevant Objectives.

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<sup>12</sup> The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

<sup>13</sup> UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at [www.gasgovernance.com](http://www.gasgovernance.com)

<sup>14</sup> As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see : <http://epr.ofgem.gov.uk/Pages/EPRIinformation.aspx?doc=http%3a%2f%2fepr.ofgem.gov.uk%2fEPRFiles%2fStandard+Special+Condition+PART+A+-+Consolidated+-+Current+Version.pdf>

<sup>15</sup> 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.

***Standard Special Condition A11.1 (d): the securing of effective competition between relevant Shippers, between relevant Suppliers, and between Distribution Network Operators and relevant Shippers***

The Proposer and other respondents believe that allowing a TU to accede to the UNC, without holding a gas shipper licence, would remove a potential barrier to entry and encourage additional parties to participate in the gas market. This would be consistent with facilitating effective competition.

On the other hand, some of the respondents were concerned that removing the requirement to hold a shipper licence could reduce regulatory oversight of some participants in the market and distort competition. Some respondents also doubted whether removing this requirement actually reduces the administrative burden on Gas Traders, as some of these will likely need to comply with Financial Services Authority (FSA) regulation instead. One respondent believed that TUs would need to identify which parts of the UNC are relevant and which are not, and this would create an additional barrier to entry.

Some of the respondents raised concerns that the modification proposal might have unintended consequences on security and safety of supply. In particular, they were concerned that this proposal might create discrimination in the context of the Significant Code Review on Gas Security of Supply (Gas SCR) that Ofgem has undertaken. On this point, one respondent to our 'minded to' consultation raised the concern that a Gas Trader may be able to avoid increased cash out penalties by failing to post credit margins and then entering into administration. In their view, the Trader could then re-enter the market under a replacement Trader user identity without penalty and Ofgem would have no say in the matter.

In relation to the concerns on gas safety and security of supply, we note that the relevant obligations, in terms of co-operation in case of an emergency and safety of the system, were inserted into the legal text. We also note that the HSE have written a response to the UNC338 consultation expressly stating that: "*The strength of the legal text wording in section Q gives confidence that the necessary cooperation by Gas Traders with the NEC [Network Emergency Coordinator] and SO [System Operator] will be achieved if and when required, via the necessary incentives*". Therefore, we do not agree with the respondent that this is a valid concern which should prevent implementation of UNC338V.

In relation to the Gas SCR, we note that Gas Traders are exposed to cash-out charges (and credit requirements) under the UNC and would continue to be exposed to such charges even without a shipper licence. We also note that the credit rules contained in Section X of the UNC allow National Grid to require Users to make additional payments where a credit limit is exceeded, and to terminate a User who does not make this payment after one business day. We note the point, made by this respondent, that if a Trader goes into administration the costs are socialised between the remaining UNC parties, but we also note that this is true whether the failing party holds a shipper licence or not.

As highlighted by the issue discussed above, we are also concerned that there may be a prevailing perception that the granting of a licence to an applicant can of itself give future counterparties some assurance as to their bona fide nature. Our licence application process should not replace the need for normal due diligence and 'know your customer' checks. We consider that a more thorough application of such checks by the industry will

give greater – and better founded – confidence to market participants and again provide a marginal improvement to competition.

We finally note that Ofgem has enforcement powers in cases of suspected market abuse under the Competition Act 1998, regardless of whether the abusing party is licensed or not. In addition to this, the Authority will be given further powers for monitoring and enforcement through the implementation of the EU Regulation on Wholesale Energy Market Integrity and Transparency (REMIT).<sup>16</sup>

Therefore, we consider that the policy change facilitated by UNC338V would not create additional burdens and would not lead to a gap in regulation, as those activities subject to regulation under the Gas Act and other statutes will continue to be regulated. In addition, any Gas Traders who are no longer directly regulated will remain subject to the terms of the UNC, which itself is subject to regulatory oversight. Instead, it would remove a burden from Gas Traders, namely the need to obtain a shipper licence in order to operate under the UNC. This should facilitate entry to the market, particularly for smaller parties, and this should have a positive, albeit marginal, impact upon competition.

We therefore consider that the implementation of this proposal will better facilitate Relevant Objective (d).

***Standard Special Condition A11.1 (f): so far as is consistent with subparagraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code.***

Some of the respondents argued that allowing non-licensed parties to make modifications to the UNC that have no direct impact on themselves, but impact the contractual relationship and obligations of other parties, is not consistent with the promotion of efficiency in the administration of the code.

We do not consider that this is a new issue as certain sections of the UNC already apply to only a sub-set of parties, without their ability to raise modifications being in any way restricted. We consider it unlikely that such parties would raise modification proposals to anything other than provisions which have a direct relevance to their interests. All proposed modifications will in any case be assessed against, and must be shown to further, the Relevant Objectives of the UNC in order to be approved and implemented. We therefore disagree that UNC338V will be detrimental to the UNC modification procedure or the efficient administration of the UNC more generally.

Some respondents also considered that it would be inefficient to implement this modification proposal now, as European developments may introduce an EU-wide energy wholesale trading passport. However, the proposals referred to are part of a consultation document from the European Regulator's group CEER (Council of European Energy Regulators), not proposed legislation. We are not aware of any immediate plans to create a trading passport regime for energy wholesale market trading. Furthermore, the CEER proposals are aimed at financial traders only. We therefore do not consider these proposals to have an impact on the modification.

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<sup>16</sup> Regulation (EU) No 1227/2011 of the European Parliament and the Council on wholesale energy market integrity and transparency available online at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:326:0001:0016:en:PDF>

For the above reasons, we consider this modification proposal would be neutral in relation to Relevant Objective (f).

### **Decision notice**

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority hereby directs that modification proposal UNC 338V: Remove the UNC requirement for a 'gas trader' User to hold a Gas Shipper Licence be made.

**Declan Tomany**

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