Modification proposal:	**Uniform Network Code (UNC)534: Maintaining the efficacy of the NTS Optional Commodity ('shorthaul') tariff at Bacton entry points (UNC534)**		
Decision:	The Authority[1] directs this modification be made[2]		
Target audience:	UNC Panel, Parties to the UNC and other interested parties		
Date of publication:	22 October 2015	Implementation date:	To be confirmed by the Joint Office

Background

The Optional Commodity tariff (also known as the "shorthaul charge") can be paid by National Transmission System (NTS) users as an alternative to standard Transmission Owner (TO) and System Operator (SO) commodity charges. The shorthaul charge aims to reflect the costs of transporting gas over short distances. Paying standard commodity charges in these circumstances could incentivise NTS users to build a dedicated pipeline to by-pass the NTS. This would not be efficient as it would duplicate the existing pipeline system and increase charges for other NTS users and gas consumers.

The shorthaul charge is based on the gas flow rate and distance of a notional NTS pipeline. In order for NGG to calculate the charge, an NTS user must nominate a non-storage site[3] entry point and an exit point (or multiple exit points)[4] for the gas flow. NTS users cannot elect to flow gas from multiple entry points to the same exit point(s).

To ensure compliance with the Capacity Allocation Mechanism European Network Code (the CAM code), the Bacton Aggregated System Entry Point (ASEP) will be split into two separate entry points: the Bacton United Kingdom Continental Shelf (UKCS) and Bacton Interconnector Point (IP) entry points.[5] The split will take effect for Gas Days from 1 November 2015.

Prior to the Bacton split, NTS users could select the Bacton ASEP as the nominated entry point for the shorthaul charge. Gas brought across either the Bacton UKCS or IP pipelines would be eligible for the shorthaul charge. Splitting Bacton into two separate entry points means NTS users must now nominate either the UKCS or IP as the entry point at which gas flows will be eligible for the shorthaul charge. NTS users argue this has reduced their flexibility to manage shorthaul gas flows at Bacton.

The modification proposal

UNC534 proposes to resolve this issue by combining the Bacton entry points for the purposes of calculating the shorthaul charge. The proposer, Gazprom, considers this will restore the flexibility NTS users previously had. UNC534 will make a number of changes

[1] References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.
[2] This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.
[3] Storage sites cannot be nominated as entry or exit points in calculating the charge because NGG considers that including them would undermine the principle that standard commodity charges are paid in respect of stored gas when the gas enters and exits the NTS.
[4] Shippers can nominate multiple exit points and a single entry point. The optional commodity charge is levied on the smaller of the two daily shipper allocations at the exit points, with the assumption that any 'extra' gas must have come from another entry point or alternatively flowed to another exit point.
[5] The Bacton split was facilitated by UNC0501V - Treatment of Existing Entry Capacity Rights at the Bacton ASEP to comply with EU Capacity Regs

to the UNC to specify that a 'combined' Bacton entry point exists for the purposes of calculating the shorthaul charge. NTS users would continue to nominate either the Bacton UKCS or IP entry point for the purposes of the shorthaul charge. However, the changes implemented by this modification would make sure that where such a nomination occurs, the assumption will be that the user has nominated a 'combined' Bacton ASEP. This will allow NTS users to flow gas eligible for the shorthaul charge across both the Bacton UKCS and IP pipelines.

UNC534 will require a number of changes to the Gemini system which NTS users use to manage their capacity holdings. National Grid Gas Transmission (NGGT) has identified both 'transitional' and 'enduring' system changes could be made to implement UNC534.

The transitional system changes would reconcile the invoicing arrangements to identify and calculate the gas flows eligible for the shorthaul charge. The UNC534 Final Modification Report (FMR) explains the transitional changes in full. It is estimated it will cost around £100,000 to make these changes.

The enduring solution is estimated to cost £100,000 to £400,000 to implement, subject to confirmation of the extent of system changes necessary.

UNC534 has been submitted as a 'non user-pays' modification. This means the cost of making the system changes would be borne by the transporter. NTS users have argued in the UNC534 workgroup and consultation responses that the modification is not user pays because it is being implemented as a result of European Network Code changes. NGGT receive an allowance as part of their RIIO-T1 price control settlement to introduce UNC modifications associated with implementing European Network Code changes.

NGGT consider that the modification is user pays. The UNC534 FMR acknowledges this view and sets out how NGGT would recover user pays costs from Bacton users based on a proportion of their total flows nominated for the shorthaul charge over a two year period after the modification is implemented. A draft Agency Charging Statement (ACS) has also been provided to us which sets out how the costs of the transitional and enduring solutions would be recovered from NTS users.

UNC Panel[6] recommendation

At the UNC Panel meeting on 17 September 2015, the vote was evenly split between those who considered UNC534 would not better facilitate the UNC objectives and those who considered it would. Therefore the Panel did not recommend its approval.

Our decision

We have considered the issues raised by the modification proposal and the FMR dated 17 September 2015. We have considered and taken into account the responses to the industry consultation on the modification proposal which are attached to the FMR[7]. We have concluded that:

[6] The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.
[7] UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.co.uk

- implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC;[8] and
- directing that the modification be made is consistent with our principal objective and statutory duties.[9]

Reasons for our decision

We have assessed the modification proposal against the UNC's Relevant Objectives. We consider this modification proposal will better facilitate UNC objectives (a) and (d) and has a neutral impact on the other relevant objectives.

We have taken into account the responses received to the consultation on the modification. Of the seven responses received, five supported implementing the modification, one gave qualified support to implementing the modification, and one did not support implementation.

(a) the efficient and economic operation of the pipe-line system to which this licence relates

We consider UNC534 will facilitate this objective by maximising the volume of gas which is eligible for the shorthaul charge at both Bacton entry points.

When the Bacton split takes effect, NTS users electing to pay the shorthaul charge will only be able to nominate one of the entry points as the location eligible gas flows will enter the NTS. This means gas flowing at the other Bacton entry point, which prior to the Bacton split would also have been eligible for the shorthaul charge, will attract standard commodity charges. The increased costs of paying standard commodity charges could act as a discincentive for NTS users to flow gas at that Bacton point or increase the likelihood they consider building alternative pipeline infrastructure.

UNC534 will help avoid this situation occurring. It will allow gas entering at both entry points to be eligible for the shorthaul charge. This will ensure a larger volume of gas which NTS users intend to offtake at nearby exit points is eligible for the shorthaul charge and avoids standard commodity charges.

We also consider UNC534 reflects the shared use of the same physical infrastructure by the two Bacton entry points for the purposes of the shorthaul charge. The two Bacton entry points are geographically proximate to each other and utilise much of the same pipeline infrastructure. Given this, we consider it is correct to allow gas using that infrastructure, regardless of which entry point it came from, to be eligible for the shorthaul change. In our view, it could be argued that this would be similar to treating both entry points as 'sub-terminals' within a consolidated Bacton entry point when applying the shorthaul charge.

We acknowledge the view expressed in one of the consultation responses that only limited relief should be given to NTS users currently electing to pay the shorthaul charge at Bacton. This would help those users adapt to the effects of the Bacton split. For the

[8] As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, available at: https://epr.ofgem.gov.uk//Content/Documents/Standard%20Special%20Condition%20-%20PART%20A%20Consolidated%20-%20Current%20Version.pdf

[9] 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 as amended.

reasons set out above, we consider it is more appropriate to implement the changes proposed by UNC534, which will maximise the benefits of the shorthaul charge at Bacton.

(d) so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition:
(i) between relevant shippers;

We consider UNC534 will facilitate this objective. UNC534 will make sure that NTS users can flow gas at both Bacton entry points which is eligible for the shorthaul charge.

Without the modification, NTS users would only be able to nominate one Bacton entry point for shorthaul gas flows. This means any gas NTS users flow at the other entry point would incur standard commodity charges. This could disincentivise those users from bringing gas onto the NTS, thereby reducing competition.

It would also mean some of the gas entering at Bacton would incur the standard (higher) commodity charges even though it will utilise the same infrastructure as the gas incurring the shorthaul charge and be delivered to the same exit points, increasing costs for some NTS users.

UNC534 provides that NTS users electing to pay the shorthaul charge will be able to flow eligible gas at both Bacton entry points. This will be charged at the same shorthaul charge rate and avoid those users being placed at a competitive disadvantage through increased costs.

User pays and the Agency Charging Statement (ACS)

There was an unresolved disagreement during the development of UNC534 about whether it is a user pays modification. Broadly, the proposer and workgroup attendees considered the modification did not implement any user pays services. They considered UNC534 was required to correct the unforeseen impact splitting Bacton had on shorthaul users. As the Bacton split was implemented due to the CAM Network Code, UNC534 should be funded by the price control allowance NGGT receive to implement European code modifications.

NGGT disagreed with this view. They considered UNC534 was not directly linked to the implementation of a European Network Code. They considered the main beneficiaries of UNC534, NTS users currently electing to pay the shorthaul charge at Bacton, should pay the costs of its implementation.

The UNC534 FMR was submitted to us stating that no user pays services would be created. However, it also acknowledged NGGT disagreed with this view and set out how costs would be recovered if UNC534 was user pays: costs will be apportioned based on shippers' percentage of the aggregate flows for which the shorthaul charge was levied. The costs attributable to the interim solution will be recovered over a two year period after UNC534 is implemented.

A draft ACS was also prepared and submitted to us which set out the 'transitional' and 'enduring' user pays services which would levied on NTS users to recover the system costs.

We have considered the arguments in UNC534 FMR and consultation responses, and the proposed charges to recover user pays costs set out in UNC534 and the draft ACS. We

consider that UNC534 does implement user pays services which should be recovered from Bacton users.

We accept the arguments for consolidating both Bacton entry points for the purposes of the shorthaul charge set out in the FMR and consultation responses. However, it is also clear the beneficiaries from this change will be the NTS users at Bacton electing to pay the shorthaul charge. They will gain increased flexibility to manage the gas flows that are eligible for the shorthaul charge, and avoid paying higher standard commodity charges. In our view, it is correct that those users pay the costs associated with making the system changes required to implement UNC534.

The UNC534 FMR and a number of consultation responses considered that the modification is required due to the implementation of the CAM Network Code, which led to the Bacton split.

In our view, the proposals in UNC534 to change the application of the shorthaul charge are separate from the decision to split Bacton. They are being made to provide a service to NTS users electing to pay that charge at Bacton and not to ensure compliance with the CAM Network Code or to facilitate the achievement of its objectives. On this basis, we do not consider that the costs associated with implementing the modification should be captured by the allowance NGGT receives to introduce code modifications required by European Network Code changes.

The ACS is a charging methodology which outlines the scope and cost of the user pays services which Xoserve provides. We have reviewed the draft revised ACS submitted by Xoserve that has been updated with the inclusion of the transitional and enduring charges described above. For clarity, we expect Xoserve to submit to us a final proposed ACS that reflects the intent of UNC534 to introduce a 'transitional' service (estimated at £100,000).

We note that the FMR provides for an 'enduring service' which would allow NGGT to recover estimated system costs between £100,000 to £400,000, which is reflected in the draft ACS. We understand it is unlikely NGGT will introduce any enduring system changes before there is clarity on the European Tariff Network Code. However, should NGGT want to implement enduring system changes, before doing so they should discuss and clearly set out to NTS users what those changes are, and provide a more accurate estimate of how much they will cost to implement.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters licence, the Authority hereby directs that modification proposal UNC534 **'**Maintaining the efficacy of the NTS Optional Commodity ('shorthaul') tariff at Bacton entry points' be made.

Paul Branston
Associate Director, Gas Networks
Signed on behalf of the Authority and authorised for that purpose