

UNC Draft Modification Report		At what stage is this document in the process?
<h1>UNC 0738:</h1> <h2>Incremental NTS Entry Capacity Surrender</h2>		<div style="display: flex; flex-direction: column; gap: 5px;"> <div style="border: 1px solid #ccc; padding: 5px; display: flex; align-items: center; gap: 10px;"> 01 Modification </div> <div style="border: 1px solid #ccc; padding: 5px; display: flex; align-items: center; gap: 10px;"> 02 Workgroup Report </div> <div style="border: 1px solid #ccc; padding: 5px; display: flex; align-items: center; gap: 10px;"> 03 Draft Modification Report </div> <div style="border: 1px solid #ccc; padding: 5px; display: flex; align-items: center; gap: 10px;"> 04 Final Modification Report </div> </div>
<p>Purpose of Modification: To allow incremental NTS entry capacity to be surrendered.</p>		
	Panel consideration is due on 21 January 2021 <i>(at short notice by prior agreement)</i>	
	High Impact: None	
	Medium Impact: None	
	Low Impact: Shippers	

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Timetable			
Modification timetable:			
Initial consideration by Workgroup	05 November 2020		
Amended Modification considered by Workgroup	03 December 2020		
Workgroup Report presented to Panel	17 December 2020		
Draft Modification Report issued for consultation	17 December 2020		
Consultation Close-out for representations	12 January 2021		
Final Modification Report available for Panel	14 January 2021		
Modification Panel recommendation (at short notice)	21 January 2021		

1 Summary

What

This proposal seeks to allow Users to surrender incremental NTS entry capacity allocated as a result of bids in quarterly system entry capacity auctions in the period from April 2017 to September 2020.

Why

When developing projects that require NTS entry capacity, incremental entry capacity will be released if National Grid's requirements for releasing capacity are met. By meeting these requirements, the principle of user commitment is delivered. Bids for NTS entry capacity assessed in auctions between April 2017 and September 2020 were assessed on the basis of the published reserve prices, and Shippers were able to develop bidding strategies designed to meet the entry capacity release requirements.

Following implementation of Modification 0678A, Amendments to Gas Transmission Charging Regime (Postage Stamp) , the prices to be paid for incremental capacity can be materially different to the prices that triggered incremental capacity being allocated, and the resulting user commitment may be materially increased. Bidding strategies may have been materially different if the eventual prices had been known, although still designed to ensure the necessary user commitment was demonstrated.

How

It is proposed that Users are able to apply to National Grid NTS to surrender incremental capacity that was allocated in the period from April 2017 to September 2020. If National Grid NTS accept the application, the User's capacity holdings will be reduced.

2 Governance

Justification for Authority Direction

Whilst the Proposer had originally suggested that this Modification should be Self Governance, UNC Panel determined that Modification 0738 is likely to have a material effect because of the value of incremental capacity that would fall within the remit of this Modification proposal. Hence self-governance is not appropriate, and Modification 0738 will therefore follow Authority Direction procedures.

Workgroup participants reviewed the Self Governance criteria and whilst some believe that due to parties incurring an additional cost as outlined in the tables in the Workgroup impact assessment section of this report, that they believe that this does not meet the self-governance criteria and should follow authority direction. Further information on the self-governance criteria is covered under the workgroup assessment.

Requested Next Steps

This Modification should:

- Should follow authority direction
- Be issued to consultation

3 Why Change?

Development of projects that require NTS Entry Capacity can be underway at any time. Having assured NTS entry rights is a critical project issue. The routes for acquiring NTS Entry Capacity are well established, notably bidding for incremental entry capacity in QSEC auctions. Incremental capacity will be released if National Grid's requirements for capacity release are met. By meeting these requirements, the principle of user commitment is delivered.

While Modification 0678, Amendments to Gas Transmission Charging Regime, was under consideration, entry related projects were not put on hold. Those requiring entry capacity after April 2017 could see the published reserve prices and create bidding strategies based on those prices. This was the only possible strategy since any such bids would be assessed by National Grid NTS on the same basis. Following implementation of Modification 0678A, Amendments to Gas Transmission Charging Regime (Postage Stamp), the prices to be paid from 1 October 2020 for incremental capacity released after April 2017 can be materially different to the prices that triggered incremental capacity being allocated, and the resulting user commitment may be materially increased. Bidding strategies may have been materially different if the eventual prices had been known, although still designed to ensure the necessary user commitment was delivered.

A consequence of Modification 0678A being implemented is therefore that some Users will face costs for entry capacity that are well in excess of the indicated user commitment level, and these Users may have bid significantly differently if there had been any way in which the eventual outcome would be known. In essence, the user commitment level has been changed retrospectively, potentially leaving Users facing materially higher charges than could reasonably have been anticipated, and the Proposer would suggest that this retrospective impact appears to be an unintended consequence of Modification 0678A.

4 Code Specific Matters

Reference Documents

None

Knowledge/Skills

None

5 Solution

It is proposed that the UNC be amended to include a provision that Users who have been allocated incremental NTS entry capacity following quarterly system entry capacity auctions held in the period between 1 April 2017 and 30 September 2020 can, within one month of this Modification being implemented, make a single application to National Grid NTS for entry capacity to be surrendered. The application must indicate the amount of capacity for which surrender is being sought, which must be no more than the quantity allocated and must be specified as the reduction in capacity that is being sought each day, and the first gas day on which capacity is to be surrendered across the whole period for which surrender is being sought. The specified first gas day must be the first day in a quarter (i.e. 1 January, 1 April, 1 July or 1 October) and be more than one month after the day on which the application is submitted, and the requested reduction would apply to all days for which capacity had been booked on that and all subsequent gas days. Users would not, therefore, be able to sculpt the surrender but only specify a daily reduction to apply uniformly.

It is proposed that National Grid NTS must accept or reject each application to surrender capacity within one month of receiving such application. It is proposed that National Grid NTS accept or reject any application, based on National Grid's interpretation of the following guidance:

All capacity that was allocated in the relevant auctions of quarterly system entry capacity other than obligated capacity is within scope and may be surrendered.

Only applications that specify a single surrender quantity will be accepted, which must be specified in kilowatt hours per gas day.

Only applications that specify the first day of a quarter as the first surrender day will be accepted, and only if the specified date is more than one month after the application was received by National Grid NTS.

If the requested surrender quantity is greater than the available capacity for any day, capacity holdings should be reduced to zero for that day.

With respect to any application to surrender capacity, National Grid NTS shall calculate:

A. the value of the full commitment made by that User when incremental capacity was allocated – that is, the relevant QSEC reserve/step price multiplied by the full allocated volume, not just the requested surrender capacity.

B. the amount that the User is expected to be liable to pay for the same incremental capacity prior to the first day on which surrender is being sought – that is, the latest available capacity price published by National Grid NTS multiplied by the amount of allocated capacity up to the relevant date.

National Grid NTS should only accept an application to surrender capacity if B is greater than A.

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

None identified as no direct impact to consumers was identified.

Consumer Impact Assessment <i>(Workgroup assessment of proposer initial view or subsequent information)</i>	
Criteria	Extent of Impact
Which Consumer groups are affected?	<ul style="list-style-type: none"> None
What costs or benefits will pass through to them?	No direct costs identified to consumers. The Proposer felt that the indirect effects of this modification on competition would lead to marginally lower prices in principle
When will these costs/benefits impact upon consumers?	<i>Not Applicable</i>
Are there any other Consumer Impacts?	Not Applicable
General Market Assumptions as at December 2016 <i>(to underpin the Costs analysis)</i>	
<i>Number of Domestic consumers</i>	<i>21 million</i>
<i>Number of non-domestic consumers <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 >732,000 kWh/annum</i>	<i>26,000</i>

Cross Code Impacts

None identified

EU Code Impacts

None identified as does not impact the EU code specified. National Grid advised on Ofgem's question on similar contracts where they were called interim contracts, did have some concerns on TAR with these contracts. Refer to decision letter on Modification 0602

<https://www.gasgovernance.co.uk/sites/default/files/ggf/page/2018-12/Ofgem%20Decision%20Letter%200621.pdf>

Central Systems Impacts

It is believed that existing capacity reduction provisions in Central Systems will be able to accommodate any reductions in entry capacity holdings.

National Grid do not have functionality to hand back capacity, therefore looked at the process and there are 3 things required, removed the rights of the liability, reoffer the capacity which would only apply to obligated Capacity. The scope of this mod only applies to non-obligated capacity and initial view that these can be dealt with through existing buy-back capacity process.

Workgroup Impact Assessment

The Workgroup commenced initial discussion of this proposal as a pre modification during the October Transmission Workgroup, followed by Panel in October. UNC Panel agreed that Modification 0738 should report in December.

As detailed in the Governance section of this proposal Panel, determined that Modification 0738 is likely to have a material effect because of the value of incremental capacity that would fall within the remit of this Modification Proposal, and hence self-governance is not appropriate.

Nevertheless, UNC Panel requested that Workgroup review this decision on Self-Governance and a summary of the discussion is set out below.

Workgroup concluded, after reviewing the Self-Governance Criteria, that to assess the effect on competition in, or commercial activities related to, the shipping, transportation or supply of gas, it would be good to obtain further information on the materiality of the redistribution of costs from National Grid.

Workgroup requested National Grid to provide an analysis of incremental allocations between April 2017 and September 2020. One participant requested that National Grid look at initial commitments compared to the ongoing commitments, post-October 2020, and to present and publish this information in advance of the December Transmission Workgroup meeting. Details below:-(e.g. significant cost for few or additional costs for many). National Grid indicated that the materiality of capacity within scope was £17,428,135. The costs are based over 12 years as detailed below.

QSEC incremental allocations between 1/4/17 & 30/9/20

Type of Incremental	Capacity Amount (kWh/d)	Original value (£)	Forecast value (£)	Uplift x
Substitution	64,459	£ 64,459.19	£ 16,509,639.51	256
Non-Obligated	66,776	£ 67,689.49	£ 17,428,135.50	257
Total			£ 33,937,775.01	

Reference source for forecast prices

<https://www.gasgovernance.co.uk/sites/default/files/ggf/book/2020-07/QSEC%20notice%20for%20Oct%202020%20and%20March%2021%20Auction.pdf>

Annual Breakdown

Gas Year	Forecast Revenue (nominal £)	
	Obligated (substitution)	Non-Obligated
2020/21	1,772,947	1,908,670
2021/22	1,288,967	1,383,789
2022/23	1,407,492	1,515,567
2023/24	1,284,028	1,386,426
2024/25	1,195,134	1,290,090
2025/26	1,195,134	2,743,241
2026/27	1,195,134	1,198,417
2027/28	1,195,134	1,198,417
2028/29	1,195,134	1,198,417
2029/30	1,195,134	1,201,701
2030/31	1,195,134	1,201,701
2031/32	1,195,134	1,201,701
2032/33	1,195,134	-
Total	16,509,640	17,428,135

Given this, it was agreed that the Modification should still follow authority direction. It was noted that permitting Shippers to hand capacity back was a fundamental change and given the extent to which the facility would be used is unknown, implementation could result in a material event.

National Grid queried whether there is justification for limiting the surrender of incremental capacity based on the financial commitment required to release incremental capacity and the observation of QSEC 2020 if there is no Net Present Value ('NPV') test within that period and therefore no obvious justification to include 2020 within the Scope of this Modification. Conversely, some Workgroup Participants were of the view that where any User commitment is created by the release of capacity, then that capacity should equally qualify for this process.

An initial representation was received by Storengy in support of the Modification based on current investment decisions made in QSEC, compared to what they could be in the future. They concluded that this could be an ongoing problem for QSEC auctions, as parties continue to obtain capacity without knowing the future cost implications. Workgroup agreed with this statement. National Grid reaffirmed that it has the ability to advise and publish periodic price changes and provides notice of forthcoming changes, in the latest price change no forecasts were available for advanced publication.

The Proposer noted that parties have to make investment decisions and acquire capacity to support projects proceeding and it is unreasonable that retrospective cost variations should be permitted without an opportunity to reconsider and reappraise those decisions.

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.	None
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.	None

The proposers view is that Efficient allocation of NTS entry capacity supports Users paying for the capacity they use, delivering cost reflectivity and so helping to secure effective competition. Unpredictable retrospective changes to charges discourage investment, and removing the uncertainty, created by the present situation, for new entry projects would help to support the securing of effective competition. Proposer and Workgroup Participants agreed with this statement.

8 Implementation

No implementation timescales are proposed. However, implementation could be directly following an Authority decision to do so.

9 Legal Text

Text Commentary

Legal Text has been provided by National Grid.

The Workgroup considered the Legal Text at its meeting on 03 December 2020 and is satisfied that it meets the intent of the Solution.

Legal Text and Commentary will sit alongside this Report.

10 Consultation

Panel invited representations from interested parties on 17 December 2020. The summaries in the following table are provided for reference on a reasonable endeavours' basis only. It is recommended that all representations are read in full when considering this Report. Representations are published alongside this Final Modification Report.

Of the 3 representations received 2 supported implementation and 1 provided comments.

Representations were received from the following parties:

Organisation	Response	Relevant Objectives	Key Points
Barrow Shipping Ltd	Support	d) - positive	<ul style="list-style-type: none"> • Efficient allocation of NTS entry capacity supports Users paying for the capacity they use, delivering cost reflectivity and so helping to secure effective competition. Unpredictable retrospective changes to charges discourage investment, and removing the uncertainty, created by the present situation, for new entry projects would help to support the securing of effective competition. • Believes a limited volume of incremental capacity was released in response to bids for entry capacity based on the reserve prices that were available at the time. Subsequently, substantial changes to entry capacity prices were introduced retrospectively. National Grid NTS have indicated that the uplift in charges was 257 times, producing charges that are far higher than could have been reasonably anticipated even if it had been known that charges might be changed retrospectively. • Long term auctions provide a means for Users to demonstrate their willingness to pay for capacity and create a user commitment. If satisfied with this commitment, National Grid NTS will release capacity. To then retrospectively increase the user commitment by 257 times creates an unreasonable burden and a far larger commitment than the User may have been willing to make. While this is detrimental and unfair for those involved, it also creates a bad precedent that has the potential to deter future investment – regulatory certainty has been undermined. • Feels given the financial value potentially involved (under £2m pa), it is hard to make a case against Self-Governance.

			<ul style="list-style-type: none"> • Believes since no systems changes are involved, implementation immediately following Authority direction would be appropriate. Implementation no later than the middle of February would ensure that surrender applications could be submitted and considered ahead of Q2 2021. • Notes Barrow Shippings' ongoing entry capacity costs would be reduced since they would use the surrender opportunity. • Agrees the legal text will deliver the intent of the Solution. • Notes when long term entry capacity auctions were introduced to the Uniform Network Code (UNC), a key feature was the provision of certainty about costs. This is consistent with the general principle of regulatory certainty that is important for encouraging investment, which supports the delivery of effective competition. The scale of change seen was not predictable and was completely unexpected. While it has been suggested that Shippers should have been aware of the concept of existing contracts being treated differently, it should be noted that smallest shippers do not have the resources to follow every detail of every possible change and rely on general principles. It is not reasonable to expect very small shippers (Barrow has one employee) to be as familiar with the detail as larger organisations – indeed, the recent issues that National Grid NTS has faced with charge levels suggests that even they did not understand the change that was implemented. The proposal by National Grid NTS to further increase capacity charges to recover revenue from a subset of capacity holders exacerbates the concerns when a far better approach would have been for National Grid to absorb the under-recovery and spread any adjustment over a number of years, helping to deliver the pricing stability that is important to their customers.
National Grid NTS	Comments	d) not supplied	<ul style="list-style-type: none"> • Does not believe that this Modification meets the Self-Governance criteria and therefore should be subject to Authority direction. • This Modification proposal touches on points of principle that relate to the treatment of interim contracts and capacity hand-back (ticket to ride), as well as dealing with consequences from the implementation of Modification 0678A. The Authority should be involved in decisions regarding any precedents this Modification may set relating to such matters. • Understands as no system changes have been identified, does not plan or anticipate any meaningful delay between approval and implementation.

		<ul style="list-style-type: none"> • Believes there are additional processes required to implement this Modification, this will be based on making use of the existing buyback (surrender) functionality within the Gemini system. This is anticipated to be an ongoing annual process required for the duration of the capacity contracts that are to be surrendered. This is because reserve prices need to be known to be able to implement the planned process, and these prices are not known more than a year in advance. • Agrees the legal text will deliver the intent of the Solution. • Background. The driver behind this Modification Proposal can be identified as the change in treatment of entry capacity registered between 6 April 2017 and 30 September 2020 (referred to hereafter as interim contracts). The UNC rules at the time interim contracts were registered were that a fixed price would be applied albeit the charging arrangements had been signposted as being subject to review in the QSEC auction invitation letters over this period. On 01 October 2020, UNC Modification 0678A was implemented and the payable price for these interim contracts was changed to a floating price arrangement. • There are 4 areas for comment regarding this Modification Proposal: <ul style="list-style-type: none"> ○ 1. Payable Price for Capacity. This Modification proposes amendments to the treatment of entry capacity registered in the past (interim contracts) from April 2017 to September 2020. The scope of this amendment is limited to addressing some of the consequences of the implementation of Modification 0678A that itself led to a change to the payable price of interim contracts (noting that as outlined above the potential for changes to charging arrangements was flagged in the auction invitation). Notes that if the Modification proposal were to be implemented then capacity could not be surrendered for any gas days that have already occurred and been invoiced for. ○ 2. User Commitment. The ticket to ride principle requires Users to be committed to the capacity that they purchase. National Grid continues to support this principle, as it prevents Users overbooking capacity for no risk or cost, which may lead to inefficient development or management of the system. However, they acknowledge the practical consequences of this principle, and in this case it can be seen that entry capacity commitments to the value of c.£68k at the time of commitment are now estimated as (after
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			<p>implementation of Modification 0678A) entry capacity commitments to the value of £17.4m. The Modification Proposal puts a limit on the value of capacity eligible for surrender (the limit being the original £ value) which means the majority of eligible capacity held may be surrendered, but the original user commitment value (as measured prior to implementation of Modification 0678A) as measured by £ will be met. Continues to support the principle of capacity commitment, but at the same time appreciate the principle is pushed to an extreme example here.</p> <ul style="list-style-type: none"> ○ 3. Classes of Capacity in scope. This Modification proposal is limited to non-obligated incremental capacity. The justification for this Modification is that projects, during the interim period identified, could not be put on hold and needed to continue to buy entry capacity in order to progress. It can therefore be surmised that non-obligated incremental capacity is being used as a proxy for identifying project capacity. This is a pragmatic shorthand to identifying project capacity but does introduce the possibility of type I/II errors. i.e, type I errors being the possible existence of non-obligated incremental capacity that was not in fact bought for a project, and type II errors being the possible existence of project capacity in the form of obligated capacity. Proving the reason for buying capacity is tricky for a 3rd party to do. Only shippers are truly aware of the purpose for which they bought capacity and therefore we can make no definitive statements on the likely existence or scale of these types of errors in identifying project capacity. ○ 4. Revenue impact. The scope of this Modification proposal is limited to non-obligated capacity which is an incentive feed. Incentive revenue for year Y will have an impact upon SO allowed revenue for year Y+2. If this Modification Proposal were to be implemented, then the surrender of capacity would not have an impact upon prices published for years Y or Y+1. However, it could have an impact upon forecast prices for Y+2, and it will also have an impact upon capacity neutrality revenue for all years.
Storengy	Support	d) - positive	<ul style="list-style-type: none"> ● Supports the implementation of this proposal and believes that this will have a positive impact on the securing of effective competition.

		<ul style="list-style-type: none"> • Suggests currently the treatment of capacity allocations made in the April 2017 to September 2020 auctions is causing distortion of the competitive environment, charging far higher prices for the allocated capacity than when it was originally allocated, and therefore heavily impacting the level of competitiveness of those parties who were allocated capacity in these auctions. • Believes that the fairest way to address these issues is to allow those parties to re-assess their decisions and their capacity requirements, and allow an opportunity for parties to effectively withdraw their bids and subsequent allocations, by creating a window for surrender of this capacity. • Notes that this proposal provides a solution to many of the problems caused by allocating capacity in these auctions based on very different prices to those currently being charged. • Notes further to the UNC Panel recommendation, accepts that this proposal may have a material effect on NTS revenues collected on long-term contracts over the life-time of the allocations and hence be subject to Authority Direction procedures, although believing that the impact of these proposals will have little effect on prices within year. • Believes with the change in costs of the relevant Incremental NTS Entry Capacity having taken effect from the 01 October 2020, this is already impacting some of the capacity investments made during the April 2017 to September 2020 QSEC Auctions. Therefore, believes that this proposal should be implemented as soon as possible after any decision has been made to approve it. • Understands capacity was allocated in the April 2017 to September 2020 auctions at specific prices at the time of the auctions, with bidding parties making investment decisions based on these prices. As prices for this capacity increased substantially since these auctions (250 to 600 times the original price), both the criteria for allocating the capacity and the original basis for investment decisions may now be completely invalidated. If the current prices had been known at the time of the auction then bidding strategies, allocations, and long-term investment decisions may have been very different. • Notes as per National Grids analysis in the Workgroup report, the potential impact of surrendering all capacities is a maximum of £34m over the next 12 years. This equates to £2.8m per year if all of the relevant capacity is surrendered, and not replaced by bookings in shorter term auctions.
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		<ul style="list-style-type: none"> • Understands this value of £2.8m represents around 0.3% of total yearly allowed NTS revenues, around 0.6% of the NTS Entry Capacity revenues. Therefore if all of the capacity were surrendered then there would be a negligible effect on prices for other NTS users, and it is likely that some of these bookings will be made in shorter term auctions by the parties surrendering the capacity. • Believes the loss of these revenues would be expected to have little effect on the wider industry, but for the parties who booked these capacities this represents a huge unforeseen increase in costs, that both jeopardise competitiveness and potentially their ongoing investment and operation. • Notes that further analysis is provided in their initial representation for this Modification and Workgroup consideration. • Notes in other EU markets, such as the German Gas market, specific provisions have been introduced to protect capacity holders against excessive increases in the underlying price of the capacity product. In such cases the capacity holder is permitted to hand-back all or some of its capacity.
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Please note that late submitted representations will not be included or referred to in this Final Modification Report. However, all representations received in response to this consultation (including late submissions) are published in full alongside this Report and will be taken into account when the UNC Modification Panel makes its assessment and recommendation.

11 Panel Discussions

12 Recommendations

Panel Recommendation

Panel Members recommended:

- that Modification 0738 should [not] be implemented