Modification proposal:	**Uniform Network Code ("UNC") 0791: Contingency Gas Procurement Arrangements when a Supplier acts under a Deed of Undertaking ("UNC791")**		
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:	28 February 2022	Implementation date:	To be confirmed by code administrator

Background

When a shipper is terminated from the UNC there are existing industry processes to ensure that gas continues to flow to end consumers and that the registered supplier to those consumers is responsible for transportation charges and energy costs. Suppliers are required by Gas Supply Standard Licence Condition ("SLC") 18.4[3] to take all reasonable steps to ensure that they have such arrangements with a gas shipper in place within 25 working days.[4]

While immediate continuity of shipping arrangements is the most efficient outcome, there may be a period during which no replacement shipper is appointed due to the commercial nature of the supplier-shipper relationship, which could result in a lot of meter points without a shipper and no gas being nominated for these sites during that period. Consequently, it would be in the interest of these gas consumers to ensure a process for facilitating the continuing supply of gas to these sites at economical and proportionate cost to those consumers. Under current market arrangements National Grid Gas ("NGG") can procure gas through the On the Day Commodity Market ("OCM") as part of its residual balancing role. The OCM is GB's balancing market, where day-ahead and within-day trades occur. It is used to formulate the System Average Price and the System Marginal Prices. As it is a short-term market, we consider it

[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] Standard Licence Condition 18: Undertakings to Relevant Gas Transporters.
[4] Consolidated standard licence conditions are available on https://www.ofgem.gov.uk/industry-licensing/licences-and-licence-conditions.

may not be the most economical solution of procuring gas, and using it to procure large volumes of gas may inflate the System Marginal Price Buy ("SMPbuy price"), which in turn is likely to increase costs for consumers more generally.

The modification proposal

UNC791 was raised by NGG ("the Proposer") on 01 December 2021 and seeks to amend the UNC Transportation Principal Document, principally Sections D (Operational Balancing and Trading Arrangements) and F (System Clearing, Balancing Charges and Neutrality). The modification would introduce arrangements to allow NGG to procure gas following the termination of a shipper where a supplier acts in accordance with its Deed of Undertaking[5] until new shipping arrangements are in place. This new role would be called the 'Contingency Procurer of Supplier Demand' ("CPoSD"). The CPoSD would be limited to gas purchases at the National Balancing Point ("NBP") but would be able to purchase NBP gas in the OCM, Over-the-Counter trading and other gas exchanges. The Proposer considers this would provide greater flexibility to procure the gas on an economic basis compared to the status quo. The CPoSD would endeavour to procure ahead of the day for between 30% and 80% of the forecast requirement from front month[6] and within month contracts.

We granted urgent status for UNC791 on 08 December 2021 and set out an urgent timetable to be followed for this modification, which included a two-week consultation period.[7] Nine representations were received in response to this consultation: five supported implementation, one offered qualified support, one provided comments and two were not in support.

UNC Panel[8] recommendation

At the UNC Panel meeting on 12 January 2022, a majority of the UNC Panel considered that UNC791 would better facilitate the UNC Objectives and the Panel therefore recommended its

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[5] All Gas suppliers must give a deed of undertaking to their relevant gas transporter pursuant to Gas Supply Standard Licence Condition 18.3. The deed's terms state that if the arrangements between the supplier's shipper and the transporter end, and no arrangements with another shipper are put in place, then the supplier will be responsible to the transporter for the charges that the shipper would otherwise have paid.
[6] Gas due for delivery in the first calendar month that occurs in the future.
[7] The urgency decision was published on 8 December 2021 and can be found on https://www.ofgem.gov.uk/publications/decision-urgency-unc-modification-proposal-unc791-contingency-gas-procurement-arrangements-when-supplier-acts-under-deed-undertaking.
[8] The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

implementation with 13 in favour and one remaining silent. The majority of Panel members considered UNC791 better facilitated Relevant Objectives (a), (c) and (d).

Our decision

We have considered the issues raised by UNC791 and the Final Modification Report ("FMR") dated 12 January 2022. We have considered and taken into account the responses to the industry consultation.[9] Where panel members or consultation respondents raised specific objections to the proposal we have addressed them in this decision. We have concluded that:

- implementation of the modification proposal will better facilitate the achievement of the Relevant Objectives of the UNC;[10] and
- directing that the modification be made is consistent with our principal objective and statutory duties.[11]

Our principal objective is to protect the interests of existing and future consumers, including their interests in relation to security of supply and, as part of this, the promotion of efficiency and economy on the part of licensees. This would include the economical procurement by NGG of gas for gas suppliers of a terminated shipper, and consequently their consumers. It is consistent with our principal objective to approve this UNC modification which we consider will support the continuation of supply to consumers without increasing the gas price in the market to a disproportionate level.

Separately, we note that, notwithstanding such change, the purchasing of gas other than on the OCM should be confined to the period of 25 working days, as the supplier is obligated to take all reasonable steps to make new shipping arrangements within this timeframe under SLC 18.4 of the Gas Supplier Licence. If the supplier does not make alternative shipping arrangements, the purchasing of gas other than on the OCM would remain in place until the 'switch off' trigger for the CPoSD role is reached.

[9] UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.co.uk
[10] 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
[11] 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 for our decision

We consider this modification proposal will better facilitate UNC Relevant Objectives (a), (c) and (d) and has a neutral impact on the other UNC Relevant Objectives.

(a) the efficient and economic operation of the pipeline system to which this licence relates

The Proposer considers that UNC791 better facilitates Relevant Objective (a) because it introduces a more efficient and economic means of securing additional supplies of gas to meet the demand of consumers in the event of terminated meter points. Minimising the risk of system prices not being reflective of supply/demand fundamentals is expected to result in more efficient system usage and operation. Panel members agreed that implementation of UNC791 would have a positive impact because relying on the OCM to procure large volumes of gas may materially impact system prices to the detriment of consumers.

We agree that this modification would better facilitate Objective (a) because under the status quo, if there was a large number of shipperless meter points, NGG would be expected to procure a large volume of gas in the OCM. This could have the effect of distorting the market, leading to higher SMP prices for all users. Allowing NGG access to other markets, for the specific circumstances set out in this proposal, would safeguard the efficiencies of the market for all users and maintain the economic and efficient operation and balancing of the pipeline system. One of the fundamentals of the GB gas market is that each gas shipper is incentivised to balance its own portfolio. If there is a large number of shipperless meter points, the CPoSD will procure the gas for these sites, allowing the residual balancing role to be performed as designed: to act as an incentive for individual portfolios to balance, rather than to procure large volumes of gas.

The CPoSD will 'switch on' when a gas shipper is terminated and the associated supplier(s) is operating under the Deed of Undertaking. The gas demand for the supplier(s) must be at least 10,000,000 kWh in a day after expected trade volumes, pursuant to Modification UNC788,[12]

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[12] UNC788 is a Uniform Network Code modification which allows suppliers to deliver gas through alternative shippers in circumstances where the registered shipper at a site is terminated from the UNC. Our decision notice can be found here: https://www.ofgem.gov.uk/publications/authority-decision-unc788-minimising-market-impacts-supplier-undertaking-operation

have been accounted for. The CPoSD role will 'switch off' where the volume of gas for shipperless sites is less than 100,000 kWh in a day, after expected trade volumes, pursuant to Modification UNC788, have been accounted for. This is likely to occur when the supplier operating under the Deed of Undertaking makes arrangements with an alternative gas shipper, or following a Supplier of Last Resort process for that supplier that results in new gas shipping arrangements through the onboarding supplier. We note that one consultation respondent proposed that OCM liquidity should be used as a determinant for the 'switch off' trigger but we consider this may create more uncertainty.

(c) so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence

The Proposer considers that UNC791 better facilitates Relevant Objective (c) because it would enable NGG to purchase NBP gas for this purpose through additional means to the OCM with a forward trading capability and thus would better facilitate NGG's obligation to perform its functions in an efficient, economic and co-ordinated manner. Some Panel members agreed that implementation of UNC791 would have a positive impact because NGG would be able to more effectively purchase gas to balance system demand in these circumstances and may avoid unduly distorting the System Marginal Prices to the detriment of consumers.

We consider that this modification would better facilitate Objective (c) by allowing NGG to procure the gas for shipperless sites, where the triggers are met, through a wider range of markets. This allows NGG to form a procurement strategy which they consider, based on the market conditions at that time, to be the most appropriate and economic solution in the circumstances. This is expected to result in market prices remaining lower and thus, such a reduction should be passed through to consumers and have lesser impacts on the market than the status quo.

This Proposal intends to add a new paragraph to the UNC text which states "And when purchasing gas under paragraph 6 National Grid NTS will aim to do so on an economic basis". Three consultation responses believed the term "economic basis" should be further defined, with one suggesting that NGG should be obliged to take all reasonable steps to purchase gas on an economic basis. We consider the wording proposed to be sufficient as we expect NGG, operating as the CPoSD, to make what it considers to be the most efficient and economic procurement of gas for these shipperless sites on the basis of the market conditions and information available to it at the time. To determine this in advance would limit NGG's options and prevent the flexibility this change is designed to achieve. Two responses noted concern that shippers may try to predict the impact to their bill and try to adjust throughput accordingly to intentionally take a larger or smaller share. We note that this is also possible under the status quo and that NGG would not publish volumes or trading strategy while the CPoSD role is active, which should help to prevent this behaviour by shippers.

The Proposal states that NGG will be obliged to notify all Users as soon as reasonably practicable when the CPoSD role requirement has been triggered, and when it has ceased, and notes that aggregate gas procurement costs as a consequence of this role will be available on the monthly balancing neutrality statement published by the Central Data Services Provider.[13] However, under the Proposal, NGG shall not be obliged to publish the volumes or prices at which it has bought or sold gas. Four consultation responses noted that Ofgem should have a role in scrutinising NGG's procurement of gas on an 'economic basis', with one anticipating that details of NGG's performance will be shared after the event. Two responses requested greater certainty as to how shippers will be notified of the activation/deactivation of the CPoSD role with a further response stating this should be announced publicly, alongside daily reporting on how much volume has been procured each day to enable shippers to anticipate the associated costs incurred. Two responses also requested additional data to be provided.

We consider it is appropriate to notify Users when the CPoSD role has been triggered and ceased for transparency and to make shippers aware of the potential additional cost recovery. It is also our view that it would not be appropriate for NGG to notify the market of the volumes of gas to be procured, or alert market participants to their trading strategy, as it may skew the market by providing NGG with a competitive disadvantage. The Authority has powers to request information from licensees, including NGG, for the purposes of exercising our duties and general functions under section 34 of the Gas Act 1986. This duty includes our designated regulatory functions to monitor the markets under section 34(2A). The Authority would request data that it deems appropriate during and/or after the use of the CPoSD role to understand the actions taken and ensure that NGG has acted in a way that could be considered economic at the time of the gas procurement. We may also choose to publish a report of this information, after the CPoSD role has been switched off, if we consider that it would be appropriate to do so.

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[13] The gas industry's Central Data Services Provider ("CDSP") is Xoserve.

(d) so far as is consistent with sub-paragraphs (a) to (c) the 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

The Proposer considers that UNC791 better facilitates Relevant Objective (d) because the proposed changes are expected to reduce the cost of the related gas procurement compared with the status quo and result in lower system prices than would otherwise be the case, thereby mitigating the financial challenges being faced by market participants. The proposed method of cost recovery would mean that shippers would be exposed to the associated costs based on their market share, consistent with established balancing neutrality principles which enable effective competition, and the impact on shippers would be mitigated to the extent that suppliers pay for their supplies under the Deed of Undertaking. Some Panel members agreed that implementation would have a positive impact because more efficient and effective purchasing would lower costs and thereby reduce any mutualisation risks. This reduced risk for shippers would aid more effective competition.

We consider that this modification would better facilitate Objective (d) because it is expected to limit the likelihood of NGG becoming a dominant and distressed player in the OCM, and maintain lower system prices than under the status quo. This should facilitate the continuation of competition and limit any contagion effect on other market participants, including increased credit and collateral requirements. NGG will not profit from this role, so there is no incentive for market abuse. Similarly, the role is time-limited and the triggers for the role are pre-determined and outside of the control of NGG.

Consultation responses noted that there could be unexpected and sizeable costs to be faced by shippers. Also, that purchasing largely ahead of the day could contribute to a long system on the day which requires the same and potentially large volumes to be sold on the day to balance the system, driving down the SMPbuy price and creating mismatch between the neutrality pot and supplier contribution, increasing neutrality costs to shippers.

We acknowledge these concerns, however we consider that the status quo would be likely to cause higher costs for shippers as allowing NGG access to alternative markets, as per the Proposal, provides an opportunity for more economical gas procurement for the shipperless sites. Also, this role will not set the System Marginal Prices, which should result in a lower SMPbuy price for all market participants and, ultimately, lower consumer bills compared to the status quo. Furthermore, if NGG is required to purchase a large volume of gas in the OCM due to a large number of shipperless sites, this may send a signal that the GB market is very short of gas, distorting the market and increasing prices. One consultation response noted that they were already witnessing perverse outcomes on the OCM as a result of NGG purchasing in a long system.

A consultation response stated that they believe the proposed arrangements appear to be designed for the CPoSD to carry out hedging activity, rather than just ensuring sufficient access to liquidity. They also stated that as soon as the trigger is met, the CPoSD must immediately procure no less than 30% of the Forecast Requirement from balance of month or front month. This could result in an immediate fall in the use of OCM liquidity below the trigger and believe an alternative arrangement without a step downwards would be more appropriate. We consider that purchasing forward to hedge the risk provides some certainty on the cost of gas and mitigates against the risk of market volatility, but also that allowing the CPoSD to access a range of markets, one of which would remain the OCM, allows the flexibility of a diverse and economic trading strategy.

We note that a consultation respondent stated that they do not think it is appropriate for NGG to be able to take speculative decisions on the timing of gas purchases from one day, week, or month to the next. The respondent argued that this may result in unintended conflicts of interest, and that NGG may need to comply with REMIT Article 3 Paragraph 1 which prohibits insider trading. In assessing this modification, we have considered the Regulation on Wholesale Energy Market Integrity and Transparency ("REMIT"). All market participants, including NGG, have to comply with the obligations of REMIT, unless a specific exemption applies. The CPoSD role will be ring-fenced, with both physical separation and anonymity between that role and the other trading roles conducted by NGG. We would expect such arrangements to mitigate the risks of NGG being placed at an unfair market advantage or any material adverse impact on effective competition between shippers. Given the likely consumer benefit that will be attained by this modification, we do not consider that the risks highlighted by this consultation response are sufficient to merit not proceeding with this modification.

Under the proposed modification, the supplier operating under the Deed of Undertaking would pay the SMPbuy price for gas procured by NGG, as per the current process under the status quo. We think it is appropriate for the supplier operating under the Deed of Undertaking to continue to pay the SMPbuy price to remain consistent with the rest of the market. Similarly, the SMPbuy price is used to incentivise the supplier to make long-term shipping arrangements. This will allow the CPoSD to function as intended as a short-term solution. We also expect the SMPbuy price to be lower under the CPoSD regime than if the status quo remained, which would benefit the affected supplier, other market participants and, ultimately, consumers.

Other issues

We note that four of the nine respondents commented on the accelerated timeline for this urgent modification, including that a shortened timescale didn't allow for full consideration of the proposal and that this may lead to unintended consequences. There were also concerns over whether there was any live risk in the market that required a change to the UNC.

We acknowledge these concerns and assessed the criteria for urgency as part of our decision on urgency. We have carefully considered whether the limited time available for review of the proposal and associated legal text would prevent us from making an informed decision. We note that this proposal received nine consultation responses and the majority of those offered support, or qualified support, for the modification. A delayed decision on UNC791 could leave a large volume of gas to be procured in the event of a shipper termination, which if purchased in the OCM could increase the price of gas for all users, including consumers. We have therefore decided that it is consistent with our broader duties that we should approve this modification.

The principal objective of the Authority is to protect the interests of existing and future consumers in relation to gas conveyed through pipes. Those interests are their interests taken as a whole including their interests in the security of the supply of gas to them. The Authority shall carry out its function in the manner which it considers is best calculated to promote efficiency and economy on the part of persons authorised by licences or exemptions to carry on any activity, and the efficient use of gas conveyed through pipes. For reasons set out in our analysis above, we consider it to be in the best interests of existing and future consumers to approve this modification to ensure that the gas suppliers of a terminated shipper, and in turn their consumers, have continuity of supply and that the cost of doing so is economical and proportionate in the circumstances.

We note a consultation respondent requested a post-implementation review on a number of areas, such as the triggers, use of the term 'economic basis' and procurement levels. We note there is an option within the UNC Modification Rules for the Modification Panel to determine that the subject matter of an urgent modification be subject to the review procedures.

Decision not to undertake an impact assessment

In our letter regarding urgency on 08 December 2021, we decided that UNC791 should be treated as an Urgent UNC Modification Proposal. In that letter, we noted that we consider this modification is "a current issue that if not urgently addressed may cause significant commercial impacts on parties, consumers, or other stakeholder(s)."

Section 5A of the Utilities Act 2000[14] ("UA00") imposes a duty on the Authority (its "Section 5A duty") to undertake an impact assessment in certain circumstances. In particular, the duty applies where it appears to the Authority that a proposal is important. A proposal is important for these purposes if its implementation would be likely to, among other things, "have a significant impact on persons engaged in the shipping, transportation or supply of gas conveyed through pipes."

The Authority has considered that it is not necessary to reach a view on whether Section 5A of UA00 is engaged because the urgency exception to the Section 5A duty applies and we are satisfied that the information and analysis provided under the industry process is sufficient to inform our decision. Those exceptions apply if it appears to the Authority that the urgency of the matter makes it impracticable or inappropriate for the Authority to comply with the Section 5A duty.

UNC791 seeks to mitigate the impact to the market if a shipper failure were to occur that resulted in a large number of shipperless meter points. Our decision provides NGG with the option to procure gas on a range of markets, providing greater flexibility to procure the gas on an economic basis compared to the status quo. In reaching this decision, we have fully

[14] https://www.legislation.gov.uk/ukpga/2000/27/section/5A

considered and taken account of the potential impacts of the proposed solution. We consider that the consultation performed by the Joint Office of Gas Transporters provided sufficient opportunity for opinions to be expressed and that an additional consultation would not provide sufficient further information on the proposed modification.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters licence, the Authority hereby directs that modification proposal UNC791: 'Contingency Gas Procurement Arrangements when a Supplier acts under a Deed of Undertaking' be made.

David O'Neill
Head of Gas Markets and Systems
Signed on behalf of the **Authority** and authorised for that purpose