UNIFORM NETWORK CODE - MODIFICATION PROPOSAL

REFERENCE NUMBER 0210

Implementation of DNPC03 (LDZ System Charges – Capacity / Commodity Split and Interruptible Discounts), the Alignment of Failure to Interrupt Charges and the Alignment of the IFA Charge

REPRESENTATION

SUBMITTED BY Rolls-Royce Power Development Ltd ("RR")

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A. SUMMARY OF RR'S REPRESENTATION

1. **The implementation of Modification Proposal 210 as drafted will lead to a 137% increase in LDZ system charges at the 4 interruptible supply points for RR's 50 MWe open cycle gas gas turbine plants ("*OCGT plants*") at Bristol Energy, Exeter Power, Croydon Energy and Heartlands Power. ("*the RR OCGT interruptible supply points*") as from 1 October 2008.**

2. **This is because the Modification Proposal will remove the current provision in the UNC that DN interruptible supply points are exempt from LDZ capacity charges:** UNC Transition Document Part IIC 9.1.9(a)**.**

3. **The stated purpose for removing this exemption is to allow the GDNs to amend their Transportation Charging statements with effect from 1 October 2008 to introduce a requirement that Registered Users at DN interruptible supply points will pay capacity charges equal to 47.37% of those paid by an equivalent firm connection "*the 47.37% LDZ interruptible capacity charge*").**

4. **The stated purpose of introducing the new 47.37% LDZ interruptible capacity charge is to maintain the existing value of capacity charge discounts received by DN interruptible supply points:** Draft Modification Report, section 1**.**

5. **However, the proposed increase in the LDZ charges for RR's OCGT interruptible supply points will be massively in excess of that required to maintain the existing value of capacity charge discounts.**

6. **The combined LDZ commodity and capacity charges at RR's OCGT interruptible supply points will be in excess of £730,000 per annum, compared to a commodity charge of £329,470 that would have applied if commodity charges had been set to recover 50% rather than 5% of the GDNs' allowed revenue. (See attached**

spreadsheet). This combined charge is over £400,000 p.a. higher than the charges necessary to maintain the existing value of the capacity charge discount. Over the three year transitional period from 1 October 2008 to 1 October 2011 this excess charge will amount to £1.2 million.

6. **This increase is wholly disproportionate to the stated objective and unduly discriminates against RR's interruptible supply points.**

7. **It appears that this effect is wholly unintended both by the GDNs and by Ofgem.**

8. **The problem arises because of the special position of RR's OCGT interruptible supply points. RR's OCGT plants connected to these supply points are 50 MWe 38% efficient open cycle gas turbines. Electrically they are connected to the local electricity distribution systems, and act as 'negative demand' on those systems at times of peak electricity demand. They are efficient, clean peak electricity power providers. They are not operated as base-load plants. They typically operate for only 1,000 hours per annum. Consequently they have a high SOQ (2,200,000Kwh) and a low AQ (143,600,000 Kwh). A new 47.37% LDZ capacity charge on these supply points would not maintain the existing value of their capacity charge discounts – it would more than double their LDZ charges**

8. **This issue has not been identified or considered in the current Draft Modification Report.**

9. **RR requests that the issue is drawn to the attention both of the Modification Panel and of Ofgem.**

10. **The provision in the UNC which exempts interruptible supply points from LDZ capacity charges should not be removed without addressing this issue.**

11. **Modification Proposal 210 should not be implemented prior to this issue being properly addressed, so that any new LDZ capacity charges imposed on RR's interruptible supply points do not go beyond what is required to maintain the existing value of capacity charge discounts received by those supply points.**

Solutions to the Issue

12. **One solution is to amend Modification Proposal 210, so that the removal of the UNC exemption from LDZ capacity charges is accompanied by an appropriate cap on the amount of LDZ capacity charges that can be levied by GDNs, so that such charges do not exceed what is required to maintain the existing value of capacity charge discounts. This would be consistent with the stated purpose of introducing the new 47.37% LDZ capacity charge. It would ensure that the new charge did not have effects that were disproportionate to its stated purpose.**

13. A simple amendment would limit the maximum amount of LDZ capacity charges on DN interruptible supply points to nine times the amount of the LDZ commodity charges at those points. This would maintain the existing value of capacity charge discounts.

14. There may be other solutions which commend themselves to Ofgem and/or the Transporters. For example, prior to implementation of Modification Proposal 210, the GDNs could undertake and Ofgem could agree and/or direct that the GDNs would not, in their amended Transportation Charging Statements, levy LDZ charges on interruptible supply points which went beyond the stated purpose of maintaining the existing value of capacity charge discounts.

15. RR strongly submits that any solution (whether by amendment to Modification Proposal 210 or otherwise) must be securely in place before Modification Proposal 210 is implemented, and the UNC provision which protects RR's interruptible sites from LDZ capacity charges is removed or altered.

B. FURTHER DETAILED SUBMISSIONS

These further detailed submissions track the sections of the Draft Modification Report ("DMR") and contain RR's representations relating to them.

Section 1 DMR The Modification Proposal

Section 1 of the Draft Modification Report summarises the history and purpose of Modification Proposal 210 as follows:

> *In February 2006 Ofgem published their document "Conclusions on the review of the structure of gas distribution charges". One of the conclusions of this document was that increasing the proportion of capacity related charges would better reflect the actual balance of capacity and commodity related costs of gas distribution. Ofgem also suggested that more cost-reflective charges could have a significant impact on the efficient use of the Distribution assets and help reduce future investment costs. These savings would eventually be reflected in lower charges to all customers. A higher proportion of capacity related charges would also bring additional benefits to users in the form of more stable charges.*
>
> *A consultation paper on behalf of all Gas Distribution Networks (GDNs) ('LDZ System Charges - Capacity / Commodity Split and Interruptible Discounts',) known as DNPC03, was issued in July 2007. Following on from consultation the GDNs put forward a proposal to modify their charging methodologies with effect from 1st October 2008. Ofgem issued a Draft Impact Assessment in October 2007 and issued a final version, in conjunction with their decision letter, in December 2007; Ofgem decided not to veto the proposal.*

> *This UNC Modification Proposal has been raised as a result of the Ofgem decision which allows the GDNs to "amend their charging methodologies with effect from 1 October 2008 so that:*
>
> *• The proportion of revenue collected from the Use of System capacity charges increases from 50% to 95%, while the proportion collected from Use of System commodity charges decreases from 50% to 5%.*
>
> *• Interruptible supply points pay capacity charges equal to 47.37% of those paid by an equivalent firm connection, so maintaining the existing value of capacity charge discounts received by these supply points".*

RR Submissions

It is clear from Section 1 of the Draft Modification Report that the purpose of imposing a new LDZ capacity charge on interruptible supply points (equal to 47.3% of the firm capacity charge) is simply to maintain the existing value of capacity charge discounts received by interruptible sites.

This is also clear from the earlier documents referred to in Section 1 of the Draft Modification Report, including Ofgem's Decision Document and Impact Assessment on DNPC03. Section 1.6 of Ofgem's Final Impact Assessment Decision Document 291a/07 describes the new 47.37% LDZ capacity charge as "*maintaining the existing value of capacity charge discounts received by these supply points*". The objective was always a simple one - to prevent interruptible supply points gaining an unintended windfall benefit from the rebalancing of the DN commodity and capacity charges.

(a) The effect on RR of this proposal is not consistent with the stated objective

As explained above, in the case of RR's OCGT interruptible supply points the effect of a 47.37% LDZ capacity charge, without an appropriate cap, is an increase in LDZ charges which is massively in excess of this objective.

After the DNPC03 rebalancing, LDZ capacity charges will be set to recover 95% of GDN allowed revenue, and LDZ commodity charges will be set to recover 5% of GDN allowed revenue - compared to 50% each, at present. If the DNPC03 rebalancing did not occur, interruptible supply points would pay commodity charges which recovered 50% of the allowed revenue – rather than 5%. In order to maintain the existing value of the capacity charge discounts received by interruptible supply points they should pay (as capacity charges) an amount similar to the amount by which their commodity charges have been reduced. But the charges for RR's OCGT interruptible supply points are massively in excess of this.

(b) This issue is not identified in the current Draft Modification Report.

(c) It has not been considered in any of the previous documents

This includes the impact assessments required by section 5A of the Utilities Act prior to Ofgem's approval of DNPC03

(d) It appears to be a wholly unintended effect.

(e) The effect of the measure is not proportionate

The impact of this measure (as currently proposed, and without any cap on the new 47.37% LDZ interruptible capacity charge) is not justified by the stated objective and is wholly disproportionate in the case of RR's OCGT interruptible supply points. Measures and charges which are disproportionate to the stated objective are contrary to EU law.

(f) The increased charges are discriminatory

Imposing these massive charge increases on the RR OCGT interruptible supply points, which are not justified by the stated objective, also discriminates against RR and RR's OCGT interruptible supply points. The LDZ charges which would be levied on RR's interruptible supply points (unless this proposal is amended) will be massively in excess of those required to maintain the existing value of the capacity charge discounts at these supply points. This has serious adverse consequences for RR and for its ability to operate these OCGT plants competitively. Again, this is contrary to EU law.

(g) The "cap" solution

The measure can be made proportionate to its stated objective by a simple amendment to include a cap on the maximum amount that can be levied under new 47.37% LDZ interruptible capacity charge, so that the charge meets the stated objective of **maintaining the existing value of capacity charge discounts.**

A provision that the proposed new 47.37% LDZ interruptible capacity charges at a supply point should not exceed 9 times the amount of the new LDZ commodity charges at the same supply point would maintain the existing value of capacity charge discounts at that point.

(h) The current exemption from capacity charges contained in the UNC should not be removed or Modification Proposal 210 implemented until this issue is properly addressed.

Section 2 DMR — Extent to which implementation of the proposed modification would better facilitate the relevant objectives

Standard Special Condition A11.1 (a): the efficient and economic operation of the pipe-line system to which this licence relates

The Draft Modification Report states:

By facilitating the implementation of DNPC03 and maintaining the current level of failure to interrupt charges this Modification Proposal may be expected to facilitate this relevant objective and help to ensure the efficient and economic operation of the pipe-line system

<u>RR representation</u>

This is simply not the case for RR's OCGT interruptible supply points.

- **The Modification Proposal does <u>not</u> maintain the current level of failure to interrupt charges.**

- **It imposes charges on the RR OCGT interruptible supply points which are over double the amount required to achieve this objective.**

- **Nothing in the analysis of efficiency or economic operation in DNPC03 justifies this.**

<u>Standard Special Condition A11.1 (c): so far as is consistent with subparagraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;</u>

The Draft Modification Report states:

Implementation of this Proposal will allow the change to the GDN's charging methodology to be implemented on 1st October 2008 and therefore be consistent with SSC A5, this in turn would therefore better facilitate this relevant objective.

<u>RR representation</u>

The Modification Proposal should not be implemented without measures which prevent this unintended effect. There is ample time before 1 October 2008 to introduce the necessary amendments to MP 210 (or other measures) necessary to address this issue.

- **If this issue is not addressed, the implementation of MP 210 will <u>not</u> be consistent with SSC A5, and therefore not consistent with SSC A11.1(c).**

- **The massive increase in RR's charges has no justification within the analysis in DNPC03, and therefore cannot be said to be consistent either with DNPC03 or with SSC A5.**

- **The disproportionate and unintended impact on RR's OCGT interruptible supply points is contrary to SSC A(5)(c) (facilitating effective competition between gas shippers and gas suppliers).**

<u>Standard Special Condition A11.1 (d): so far as is consistent with subparagraphs (a) to (c) the securing of effective competition: (i) between relevant shippers; (ii) between relevant</u>

suppliers; and/or (iii)between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;

The Draft Modification Report states:

> *Implementation of appropriate charging methodologies will help to ensure that there is no inappropriate discrimination between different market sectors and that, in this instance, charges to interruptible sites remain cost reflective and Users are not in receipt of inappropriate 'discounts' or subject to inappropriate failure and IFA charges. We therefore believe that implementation of this Modification Proposal is likely to better facilitate this relevant objective.*

RR Representation

The massive charge increases for RR's OCGT interruptible supply points are not justified by the reasons given in the Draft Modification Report, or in the DNPC03 Ofgem decision documents. They are disproportionate and discriminatory. They will lead to inappropriate discrimination between market sectors. This will have a knock on effect into the electricity sector. Implementation of Modification Proposal 210, without measures to rectify this issue, is not consistent with SSC A11.1(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;

The Draft Modification Report states:

> *Implementation of this Proposal will ensure that any further changes to the LDZ capacity and commodity proportions will not require a UNC Modification Proposal to re-align the first day FTI charge or the IFA Charge. We therefore believe that implementation of this Modification Proposal will better facilitate this relevant objective by the promotion of efficiency in the administration of the UNC.*

RR representation

It is not acceptable that a provision of the UNC which expressly protects interruptible supply points from LDZ capacity charges should be removed without proper protection for the persons who will be affected. The UNC protection should only be removed if the UNC itself guarantees that LDZ capacity charges will only be levied on interruptible sites for the purpose of, and to the extent required by, the identified objective. Or, at the very least, that some other binding assurance is given before this protection is removed. At present this is simply not the case.

Section 7 The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

The Draft Modification Report identifies no implications.

RR Submissions

The DMR should identify the fact that implementation of the Modification Proposal has an adverse effect on the Registered Users at RR's OCGT interruptible supply points, because it will give rise to massive increases in LDZ charges at these supply points which are not justified by the objective stated in the Draft Modification Report or in DNPC03.

Section 8 The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and any Non Code Party

The Draft Modification Report states:

> ***No such implications have been identified for any other relevant persons.***

RR Submissions

This confirms that the issue which concerns RR has simply not been identified. It should be identified in the Modification Report, and a solution should be in place before the Modification Proposal is implemented. There is a very substantial adverse implication for RR itself.

Section 9 Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal

The Draft Modification Report states:

> *As a Gas Distribution Network (GDN) we are obliged to keep our charging methodology under review to ensure that the objectives of the charging methodology are being achieved further to Standard Special Condition (SSC) A5 (2A)(a) of the gas transporters' licence. The pricing consultation DNPC03 resulted in a proposed modification to the GDN's charging methodologies, Ofgem decided not to veto that proposal. Implementation of this Modification Proposal will allow the GDNs to successfully implement the change to the charging methodology and be consistent with SSC A5.*

RR Submissions

1. Modification Proposal 210 (unless amended) will lead to LDZ charge increases on RR's OCGT interruptible sites which (a) are not justified by the objective stated in the Modification Report or in DNPC03, (b) are disproportionate and (c) are discriminatory.

2. This is not consistent with SSC A5.

3. It would breach the Transporters' statutory obligation to avoid any undue discrimination: Section 9(2) of the Gas Act 1986 (as amended).

4. It would breach the Transporters' obligations of proportionality and non-discrimination under the general principles of EU law and under EU Directive 2003/55/EC. Article 12.2 of the Directive requires distribution system operators not to discriminate between system users or classes of system users. Article 25.4 provides that distribution tariffs and charging methodologies should be proportionate and applied in a non-discriminatory manner.

Section 10 Analysis of any advantages or disadvantages of implementation of the Modification Proposal

The Modification Report does not identify any disadvantages of implementing the Modification Proposal.

RR Representation

The Modification Report should identify, as a Disadvantage of implementing the Modification Proposal, the issue identified in this Representation.