Modification Report
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
Modification Reference Number 0210
Version 3.0

This Modification Report is made pursuant to Rule 9.3.1 of the Modification Rules and follows the format required under Rule 9.4.

1 The Modification Proposal

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".

The proportion of revenue collected from the Use of System capacity charges and commodity charges are not set out in the UNC and the majority of DNPC03 will be implemented through changes to the individual GDN's Transportation Charging Statement. However, the UNC currently states that in respect of an Interruptible Supply Point the Registered User shall not be required to pay NTS Exit Capacity Charges or LDZ Capacity Charges (UNC Transition Document Part IIC 9.1.9(a)). The intention of this UNC Modification Proposal is to remove the part of this exemption that relates to LDZ Capacity Charges. For clarity, the Registered User would still not pay NTS Exit Capacity Charges.

An unintended consequence of the change to the charging methodologies will be to increase the first day Failure to Interrupt (FTI) charge by 90%. For the first day of failure, the FTI charge is currently charged at two times the Applicable Annual Rate of the **Firm** LDZ Capacity Charge (UNC Transition Document Part IIC 9.9.2(a)(i)).

With the change in Capacity from 50% to 95%, the first day FTI charge would rise by 90% if no further change were made. The GDN's preferred solution to this, and the intent of this Proposal is to amend the first day FTI charge to be two times the difference between the Applicable Annual Rate (as introduced by DNPC03 at 1st October 2008) and the Firm Applicable Annual Rate; this will maintain the current level of the first day FTI charge.

In a similar way the change to the charging methodologies will also impact on the 'IFA Charge' (charges payable, by the Registered User, to the DN Operator and National Grid NTS where a relevant Supply Point has an Interruptible Supply Point Firm Allowance). The IFA Charge, payable to the DN Operator, is currently based on the Firm LDZ Capacity Charge and is supplementary to the LDZ System Charges (UNC Transition Document Part IIC 10.4).

With the change in Capacity from 50% to 95%, and the introduction of the interruption LDZ Capacity Charge, the IFA Charge will increase by approximately 53%.

We are therefore proposing that the IFA Charge payable to the DN Operator as a single charge in October of each year (not National Grid NTS) is calculated as equivalent Firm LDZ Capacity Charge, based on the Firm Allowance, (using it as the SOQ of the firm element), less any capacity payments expected over the subsequent 12 months made in respect of the Firm Allowance and paid as interruptible LDZ Capacity Charge, (resulting from the implementation of DNPC03 on 1st October 2008).

There is also an incorrect reference to 10.5.3 within UNC Transition Document Part IIC 10.4.2. This should refer to 10.4.3 and will also be amended by implementation of this Modification Proposal.

For clarification this proposal will have no impact on the following:

- Arrangements for interruptible sites directly connected to the National Transmission System
- The charge rate for subsequent days where a FTI charge is due
- IFA Charge payable to National Grid NTS
- Ratchet Charges (interruptible sites can not attract such charges under the current, transitional, arrangements)
- The basis for calculating the applicable LDZ Capacity and Commodity Charge rates (i.e. the usage of Bottom Stop SOQ for interruptible sites)

Interruption arrangements as of 1st October 2011 (commencement of revised DN Interruption Arrangements (Mod 0090))

Suggested Text

To be provided separately for the Consultation Phase.

2 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;

Standard Special Condition A11.1 (b): so far as is consistent with sub-paragraph (a), the 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;

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.

Rolls-Royce (RR) Power Development Ltd believes that the Proposal does not 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.

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

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

RR Power Development Ltd believes implementation would not be consistent with SSC A5, and therefore not consistent with SSC A11.1(c). They consider that 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).

INESOS Enterprises Ltd believes the Proposal imposes a discriminatory cost structure which seriously undermines the ability for embedded storage facilities to continue to operate.

Standard Special Condition A11.1 (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;

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. DNs believe that implementation of this Modification Proposal is likely to better facilitate this relevant objective.

RR Power Development Ltd believes the increases for its OCGT interruptible supply points are disproportionate and discriminatory.

Smartest Energy believes the steep increase in costs will disadvantage new entrants.

Standard Special Condition A11.1 (e): so far as is consistent with sub-paragraphs (a) to (d), the 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;

Implementation would not be expected to better facilitate this relevant objective.

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

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. Therefore implementation of this Modification Proposal will better facilitate this relevant objective.

3 The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

INEOS Enterprises Ltd believes the Proposal imposes a discriminatory cost structure which seriously undermines the ability for embedded storage facilities to continue to operate. They stress that the impact of this Proposal should not be underestimated as it may undermine future security of gas supplies. They believe that there is a strong case for singling out storage facilities and treating them in a different manner to other offtakes.

4 The implications for Transporters and each Transporter of implementing the Modification Proposal, including:

a) Implications for operation of the System:

No specific implications for operation of the system have been identified.

b) Development and capital cost and operating cost implications:

No development and capital cost or operating cost implications associated with implementation of this Proposal.

c) Extent to which it is appropriate to recover the costs, and proposal for the

most appropriate way to recover the costs:

No cost recovery mechanism is proposed.

d) Analysis of the consequences (if any) this proposal would have on price regulation:

No such consequences on price regulation have been identified.

5 The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal

No such consequences on contract risk have been identified.

6 The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users

There are no development, or other, implications for Transporter or Users systems

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

Administrative and operational implications (including impact upon manual processes and procedures)

No such implications have been identified.

Development and capital cost and operating cost implications

EDF Trading and Ineos Enterprises believe that this Modification Proposal will introduce a level of charge which will have serious cost implications.

Smartest Energy also expressed concern on the consequences for end users, particularly power generation providers with low AQs and high SOQs, facing a steep increase in their costs.

RR Power Development Ltd state that, if implemented, the Modification Proposal will lead to a 137% increase in LDZ system charges at the 4 interruptible supply points for RR's 50 MWe open cycle gas turbine plants ("OCGT plants") at Bristol Energy, Exeter Power, Croydon Energy and Heartlands Power. 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. 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.

Consequence for the level of contractual risk of Users

Without implementation of this Modification Proposal the level of charge associated with the first day of a failure to interrupt, and any applicable IFA Charge, will increase by 90% and 53% respectively; thus increasing the contractual risk of Users.

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

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

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

DNs are obliged to keep charging methodologies 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 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 Power Development Ltd believes implementation of the Proposal 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. As a consequence they believe this is not consistent with SSC A5, as it would breach the Transporters' statutory obligation to avoid any undue discrimination: Section 9(2) of the Gas Act 1986 (as amended) and 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.

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

Advantages

Allows implementation of DNPC03

Ensures Failure to Interrupt charges remain, unchanged, at the appropriate level

Ensures IFA Charges, payable to DN Operators are at the appropriate level

Disadvantages

Inappropriately increases transportation charges for some users, such as OCGT operators

Imposes a discriminatory cost structure which undermines the ability for embedded storage facilities to continue to operate.

11 Summary of representations received (to the extent that the import of those representations are not reflected elsewhere in the Modification Report)

Representations were received from the following parties:

Organisation	Position
British Gas	Support
E.ON UK	Support
Gaz de France	Support
National Grid Distribution	Support
Northern Gas Networks	Support
RWE	Support
Scottish and Southern Energy	Support
Statoil	Support
Wales & West Utilities	Support
Scotia Gas Networks	Support
EDF Trading	Not in Support
INEOS Enterprises Ltd	Not in Support
Rolls-Royce Power Development Ltd	Not in Support
Smartest Energy	Not in Support

Of the fourteen representations received 10 were in support and 4 were not in support of the Proposal.

EDF Trading and INEOS do not believe that the needs of storage sites have sufficiently been taken into account.

EDF Trading highlight that the changed proposed by DNPC03 effectively means that there will be a different treatment for storage sites connected to a DN and those connected to the NTS until at least October 2012. This will lead to existing facilities effectively being priced out of the market with comparison to their NTS equivalents and will deter future storage connections to DNs as it may no longer be economic.

EDF Trading and INEOS also express concerns about the DNs incentives in relation to booking NTS capacities.

12 The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation

Implementation is not required to enable each Transporter to facilitate compliance with safety or other legislation.

13 The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

Implementation is to support implementation of DNPC03.

14 Programme for works required as a consequence of implementing the Modification Proposal

No programme of works would be required as a consequence of implementing the Modification Proposal.

15 Proposed implementation timetable (including timetable for any necessary information systems changes and detailing any potentially retrospective impacts)

This Modification Proposal will need to be implemented on the 1st October 2008 in order to be consistent with the publication of the DN Transportation Charging Statements.

16 Implications of implementing this Modification Proposal upon existing Code Standards of Service

No implications of implementing this Modification Proposal upon existing Code Standards of Service have been identified.

17 Recommendation regarding implementation of this Modification Proposal and the number of votes of the Modification Panel

At the Modification Panel meeting held on 19 June 2008, of the nine Voting Members present, capable of casting ten votes, ten votes were cast in favour of implementing this Modification Proposal. Therefore the Panel recommended implementation of this Proposal.

18 Transporter's Proposal

This Modification Report contains the Transporter's proposal to modify the Code and the Transporter now seeks direction from the Gas and Electricity Markets Authority in accordance with this report.

19 Text

The following text is provided at the request of Ofgem:

UNIFORM NETWORK CODE - TRANSITION DOCUMENT

PART IIC SECTION 9

TRANSITIONAL INTERRUPTION REGIME: INTERRUPTIBLE SUPPLY POINTS

Amend paragraph 9.1.9 to read as follows:

9.1.9 In respect of an Interruptible Supply Point the Registered User (or Sharing Registered Users) shall:

(a) not be required to pay NTS Exit Capacity Charges; ~~and LDZ Capacity Charges; and~~

(b) be required (where the Interruptible Supply Point is an LDZ Interruptible Supply Point) to pay LDZ Capacity Charges with such discount applied as may be provided in the Transportation Statement; and

(c) be entitled to a payment, where in respect of an Interruptible Supply Point the Transporter requires Interruption on more than 15 Days in any Formula Year, calculated in the manner provided in the Transportation Statement.

Amend paragraph 9.9.2 to read as follows:

9.9.2 Where there is a failure to Interrupt at a Supply Point:

(a) irrespective of whether the failure to Interrupt resulted from Force Majeure, where the Transporter determines that the failure to Interrupt results in a significant risk to the security of the relevant System the Transporter may take any steps available to it to isolate or disconnect any or all Supply Meter Points (irrespective of whether any is a Shared Supply Meter Point) comprised in the Supply Point; and

(b) subject to paragraph 9.10.5, save where the failure to Interrupt resulted from Force Majeure or, in exceptional circumstances, where the Registered User can demonstrate to the Transporter's reasonable satisfaction that it made all reasonable efforts to Shutdown (including but not limited to ensuring that appropriate action is taken at the Supply Point but despite such efforts gas in excess of the Shutdown Tolerance flowed):

i) the Registered User shall on the first Day of the first failure to Interrupt in any Gas Year, pay a charge determined as:

1) in respect of an NTS Supply Point, 2 times the Applicable Annual Rate of the NTS Exit Capacity Charge ~~in respect of an NTS Supply Point or~~

2) ~~LDZ Capacity Charge where the the Supply Point~~ in respect of a Supply Point which is not an NTS Supply Point, 2 times the difference between the Applicable Annual Rate of the LDZ

Capacity Charge that would be payable (in respect of Supply Point Capacity in accordance with paragraph 9.3.9) if the Supply Point was designated as Firm and the Applicable Annual Rate of the LDZ Capacity Charge (as discounted) payable in respect of the Interruptible Supply Point pursuant to paragraph 9.1.9 (b); and

ii) the Registered User shall pay, on all days other than the first Day of the first Period of Interruption in each Gas Year, a charge determined as:

$$X = 2 * Y * Z$$

where:

X is the amount payable in respect of each Day;

Y is the quantity of gas offtaken at the Supply Point (in kWh) on the Day;

Z in any Gas Year is the price difference (in pence/kWh) taken from the figures published in Table 26 of the DTI Energy Trends (or superseding publication), for the 1st Quarter of the calendar year in which the current Gas Year commenced, between the all consumer average for Gas Oil (shown in £/tonne and converted to pence/kWh using the estimated average calorific value for Gas Oil set out in Annex B of the Digest of United Kingdom Energy Statistics) and the price of gas, all consumers, Interruptible.

Amend paragraph 10.4.2 to read as follows:

10.4.2 Where a Firm Allowance is in force under paragraph ~~10.5.3~~ 10.4.3:

(a) the Firm Allowance shall be treated as an exception to paragraph 9.7.2(b) such that the requirement that no gas shall be offtaken be read as no gas, other than the Firm Allowance shall be offtaken, and at an hourly rate not exceeding 12.5% of the Firm Allowance unless otherwise agreed with the Transporter in advance;

(b) the Registered User shall pay to the Transporter the Administration Charges (if any) set out in the Transporter's Transportation Statement;

(c) the rate of any Supply Point Transportation Charge shall be determined by reference to the Supply Point Capacity held by the Registered User at the relevant Supply Point at the time that the offer of Firm Allowance has been offered by the Transporter in accordance with paragraphs 10.4.3 and 10.4.4;

(d) the Registered User shall pay a charge (**"the IFA Charge"**) to:

i) National Grid NTS, calculated as the NTS Exit Capacity Charge set out in National Grid NTS'S Transportation Statement;

ii) the relevant DN Operator, calculated as the difference between the

LDZ Capacity Charge set out in the relevant DN Operator's Transportation Statement and the discounted LDZ Capacity Charge payable pursuant to Clause 9.1.9 (b) determined in respect of an amount of Supply Point Capacity equal to the amount of the Firm Allowance;

(e) for the purposes of determining the IFA Charges payable by the Registered User in respect of the provision of a Firm Allowance at an NTS ~~the relevant~~ Supply Point, the Firm Allowance shall be regarded as the Supply Point Capacity of a Firm Supply Point;

(f) all amounts payable under this paragraph ~~10.5~~ 10.4 shall be payable in a single payment, may be invoiced by way of an Ad Hoc Invoice, at any time after the Registered User's election and shall be paid in accordance with TPD Section S. The charges shall be fixed in accordance with paragraph 10.4.2(h) having regard to the date on which the period of the Firm Allowance commences in accordance with paragraph 10.4.3(c) or 10.4.4 and are not refundable;

For and on behalf of the Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters

