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Stuart Cook
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Dear Stuart,

Project TransmiT: A call for evidence

ESB International (ESBI) welcomes the opportunity to respond to Ofgem's call for evidence on the current network charging arrangements. As a developer of both conventional thermal and renewable generation in GB, network charges are a key factor for our business. Whilst we agree that the charging principles and mechanics should, from time to time, be checked for their continued relevance, we would urge Ofgem to be mindful of the considerable uncertainty Project TransmiT brings when significant investment is required in the GB energy markets to ensure achievement of Governments policy objectives. This response provides a brief overview of ESBI and general views on Ofgem's call for evidence and the current charging arrangements.

ESB International

ESBI has been a developer of independent Combined Cycle Gas Turbine (CCGT) generation projects in the GB market for over fifteen years. We currently have interests in Corby power station and in the 850MW development at Marchwood, which commissioned late last year. We also recently announced our latest 860MW development at Carrington which is planned to commission in 2013. We are also developing other large CCGT developments at various locations across GB. It is ESBI's intention to build 3GW of thermal generation in Great Britain in the next decade.

In addition to increasing our conventional generation fleet, we are also seeking to expand our GB portfolio of renewable generation sites, having recently announced the acquisitions of Fullbrook Down, West Durham and Mynydd Y Betws windfarms. All these developments are set within the context of a wide-ranging programme adopted by the ESB group to facilitate the transition to a low carbon economy.

ESBI Investments is a trading name of ESB International Investments Limited.

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Summary of views

We provide more detailed discussion of our views below, however in summary we believe that network charges should:

- Properly reflect the costs that users incur on the networks;
- Include a robust locational signal;
- Facilitate trade and market convergence within Europe;
- Not be used to promote or penalise individual generation technologies;
- Facilitate timely and efficient connection to the networks;
- As far as possible, be stable and not unduly volatile; and
- Promote new connections by limiting pre-connection user commitment.

We would urge Ofgem to be cognisant of the Government's ongoing review and reform of the current electricity market arrangements. We are concerned that the timeline for Project TransmiT runs concurrently with that stated for Government's market reform and that the respective final proposals may not be compatible or that the interaction between the two processes may cause undue delay.

Charging principles

Both electricity transmission and gas transportation charging arrangements are based on broadly similar principles, those being:

- That charges generally reflect the costs that connected parties incur on the networks;
- That charges are non-discriminatory; and
- That, wherever possible, charges promote competition.

We are strongly of the view that these principles remain appropriate and that any changes to the charging arrangements should be consistent with them. As an independent and relatively new entrant generation developer, we strongly agree that these principles are helping to facilitate the transition to a low carbon, secure energy future whilst limiting the associated overall costs. Project TransmiT should not, therefore, seek to change or weaken the existing charging principles.

Project TransmiT scope

In general, the suggested scope of Project TransmiT appears appropriate. We particularly welcome the inclusion of European charging convergence issues in the scope. Over forthcoming years, European energy markets will increasingly converge and wherever possible, network charges should not be an inhibiting factor to that convergence and the benefits it will bring.

There are, however, a number of areas that the call for evidence specifies as being within the scope of Project TransmiT about which we have some reservations. Firstly, Ofgem states that (for electricity access and charging) “Project TransmiT will focus on the aspects of the current arrangements that fall outside the scope of the Government’s work and have been specifically left to us to resolve with industry”. If specific instructions or terms of reference for Project TransmiT have been provided by Government, we feel it is in the best interests of the process that these be made transparent.

Secondly, Ofgem has chosen to include charging arrangements for Carbon Capture and Storage (CCS) within the scope of Project TransmiT. We agree that at a point in the future, there will likely be a requirement for a carbon transportation network to facilitate carbon abatement of fossil fuel generation. There remains significant uncertainty as to how CCS policies will be implemented, as to what infrastructure will facilitate those policies and how these will be provided. We are of the view, therefore that inclusion of CCS within Project TransmiT will be an unnecessary distraction and that Government should provide greater clarity on CCS policy before regulatory and charging issues are considered.

Cost-reflectivity and locational signals

We strongly support the principle that charges should, wherever possible and practicable, reflect the costs that users of the networks incur on them. Such signals are key to ensuring the networks develop in a way that facilitates policy objectives while ensuring this is done at least cost. These cost-reflective signals should apply to all users, irrespective of type, technology or location and should continue to contribute to facilitating competitive energy markets. If particular technologies or locations are to be subsidised, we would seek for this to be done explicitly and outside of the charging regimes.

Linked to cost-reflectivity, are the locational signals inherent within the current charging arrangements. These, appropriately, reflect the fact that those located furthest away from centres of demand or supply

are subject to relatively higher charges on account of the increased use they make of the networks. We support charges that incorporate such signals and would seek that any changes include robust locational signals. There has been much debate over whether locational signals are appropriate for a world in which new sources of lower carbon generation must locate at more remote parts of the networks (Northern Scotland for example). We note that significant amounts of renewable and low carbon generation have taken account of the locational signals inherent in the current charging methodologies and located in areas which have less impact (or indeed benefits) on the networks. Before making any changes to the locational signal we would seek for Ofgem to robustly model the impacts, noting both windfall gains and the low carbon generation which would be detrimentally impacted.

Charge stability

For many investors, the absolute value of charges is not necessarily the most crucial charging consideration. The ongoing stability of the charges is often more critical. Besides major regulatory intervention (such as BETTA and gas exit reform) network charges have, on the whole, been relatively stable over recent years. We note that there are individual sites that may see annual fluctuations due to zonal averaging, however these are the exception rather than the rule. We believe Ofgem should incorporate charge stability as a key consideration for Project TransmiT. To this end, we would welcome Ofgem investigating the introduction of longer-term charges which would enable network users to hedge against future charge variations. This could provide important certainty when making investment decisions.

Should Project TransmiT conclude that changes to the charging methodologies are required, we would seek for Ofgem to limit any mid-year changes to charges. Due to the integration of the first offshore connections, this charging year has seen a material mid-year change to onshore charges. The impacts of changes such as these are, at best, inconvenient but can be significantly worse for smaller market participants. We would, therefore, welcome Ofgem being mindful of the impacts that charge instability brings and any mitigating measures taken to limit such change.

New technologies

Over the forthcoming years, new network and generation technologies will be introduced which will dramatically change the way power is generated and transported. Innovations such as the use of HVDC

links and increasingly diverse offshore generation will mean that the charging regimes will have to be able to take account of these with minimum disruption. Similarly, the changing way gas is imported and used should be analysed and any changes to the methodologies must facilitate those changes (such as increasing LNG imports and increasingly diverse sources of gas). We therefore believe that Ofgem must include these within the scope of the review and ensure (as far as possible) that any changes are “future-proofed”.

User-commitment

As discussed previously, over the forthcoming years a significant amount of new generation investment must take place to facilitate the achievement of Government’s policy goals of secure, low carbon energy. A significant barrier to the delivery of this investment is the very significant commitments and securities that must be provided when applying for, and reserving, network capacity. We welcomed National Grid’s recent initiative to reduce these liabilities for electricity connections by reducing final sums user-commitment to only being calculated on “local works”. We note that these remain interim changes and would therefore seek that Ofgem build on this progress and incorporate user-commitment within the scope of Project TransmiT.

The Interim Generic User Commitment Methodology (IGUM) provides a useful formulaic alternative to the final sums methodology for electricity connections. To further promote investment, we believe the IGUM calculation should also be included within the scope of Project TransmiT. Whilst we recognise that it would be unreasonable for National Grid to accept all the risk associated with grid applications, we are of the view that the current division of risk between applicants and National Grid is inappropriately one-sided, to the detriment of new investment.

Embedded generation

Users connecting at distribution voltages (below 132kV in Scotland and below 275kV in England and Wales) are subject to distribution network charges levied by Distribution Network Owners (DNOs). Larger users that are deemed to have an impact on the transmission systems or hold bilateral contracts with National Grid are also subject to transmission charges. Similar arrangements are in place for users connected to the Local Transportation System (LTS) for their supply of gas, rather than the National Transportation System (NTS).

Network charge issues associated with embedded generation are predominately related to electricity charges and therefore this should be the focus. Arrangements currently in place to reflect the benefit that embedded generation provides in offsetting demand (and therefore reducing or, indeed, negating investment) are complex and may require change. We therefore seek that Ofgem include these within the scope of Project TransmiT.

Conclusion

In conclusion, ESBI is of the view that at the highest level the current network charging principles remain relevant and sound. There are areas within the specific mechanics of each methodology that could benefit from further work but this should not result in a fundamental overhaul of the current arrangements. Robust cost-reflective charges do not appear to be limiting the achievement of Government policy objectives and we would seek for these principles to be maintained.

We look forward to participating in the forthcoming Project TransmiT process. Should you wish to discuss any of the issues or view raised in this response, please do not hesitate to contact me.

Yours sincerely,

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By e-mail