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Dear Nicholas,

Charges for Pre 2005 Distributed Generators' use of DNOs' distribution systems

Thank you for the opportunity to respond to the above consultation. As you know generators on the whole have been very concerned about the potential application of Generation DUoS charges to pre 2005 generators. E.ON UK is therefore most supportive of Ofgem's decision to consult within the industry on this important issue.

Our preferred option is to introduce a time limited exemption for these generators based on the explicit or implied expiration of their existing access rights. We believe that simply putting these generators onto the new use of system charges would be unduly discriminatory. Compensation could be provided as an alternative approach. However, the work associated with putting in place such a system of refunds would seem to be disproportionate to the perceived benefit of placing these generators onto the new charging structure at an earlier date. Our detailed reasoning for supporting this approach is outlined in more detail below.

We believe that it is crucial that pre 2005 generators are brought into the new DNUoS charging regime in a manner that is fair, non discriminatory and using a proportionate amount of resource to do so. This is essential to prevent undermining investment in existing generation projects which in turn could discourage future investment in the GB generation sector. E.ON UK is not averse to change in the commercial incentives facing market participants and does not believe that the trading arrangements have to stand still. However, any change must have a clear purpose and be carried out in such a manner which is proportionate and fair.

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Current Access Rights

We note from the consultation that the information collected from DNOs so far on the status of current contracts with pre 2005 generators, shows that there is a wide range of contractual arrangements. This is consistent with our understanding of the sorts of differences which include:

- Sometimes incomplete records of payments made towards wider reinforcements or what these payments were to cover exactly.
- Differing levels of clarity as to whether or not access to the system is provided as part of the agreement or whether connection only is provided.
- Some agreements containing specific termination dates, whereas others are silent on this.
- Some agreements making explicit provision for the payment of Use of System charges, where applicable, whereas others do not.

These differences make it difficult to infer from the contracts themselves the sorts of rights that were afforded to generators under the pre 2005 deep connection charging regime. Therefore, it is important to determine at a high level what the intent of a deep charging regime must have been. It is in no doubt that everyone was aware when operating under the previous regime that the DNOs as required by Ofgem operated a deep connection policy. It is also clear that we have now moved to a more shallow regime which is why locational Use of System charges have been implemented to replace the signals which were lost with the deep charges.

The industry was also aware that the deep connection charging policy required generators to pay for wider reinforcements to the distribution network, where these were necessary, before the generator could connect and use the system. Once these payments were made, perhaps with an ongoing operation and maintenance charge to pay, the generator was then entitled to export onto the network. From this it is reasonable to infer that these agreements provide for connection to and use of the DNO's network, even if this is not explicitly stated in the contracts themselves.

Therefore generators were often required to pay up front for connection to and use of the wider distribution system. Of course in many instances, generators followed the locational signals provided by the deep connection methodology and located where there were no or few reinforcements required in the wider network. This resulted in lower or no charges being paid up front. However, the same general principles would have applied. Is it now reasonable to require these generators to pay further charges on a pay-as-you-go basis through use of system charges? We believe that it is not reasonable, at least not until the rights implied by the previous pay up front methodology have expired.

Duration of Access Rights

So in the absence of a clear termination date for rights can it be determined when rights do expire? All of the proposed methods for providing recompense to pre 2005 generators require an assessment of the duration of the previous rights, either to calculate the size of refund/compensation or to ascertain how long an exemption should last. As

we mention above, many agreements do not specify termination dates. Some mention dates by which the generator should pay for the replacement of the wider works on which its connection and use of the distribution system is dependent. Others contain explicit termination dates.

We do not support a view that these rights should be regarded as evergreen. However, a deep pay up front policy must have rights associated with it that are longer than say one year. Where the requirement was to pay for the investment cost of assets until they needed replacing again, one valid approach is to infer the access right duration from this. This would imply an access right of say 40 years which may seem excessive against the possible life of a wind project. However, it would not be unreasonable to assume that the rights were to last for the expected life of the generation project itself which would perhaps imply a duration of around 25 years.

Refund or Time Limited Exemption?

As we mention above, the length of implied or specified access right is important in ascertaining the level of refund or length of exemption to give a particular project. It would not be reasonable to refund the entire amount of money paid by a generator under a deep charge for instance, particularly if it had been operating for a long time and already used a large amount of its access right. Given the varying nature of the information available as to the payments made by generators on connection and the exact assets these payments were made in respect of, making a refund to generators of payments actually made seems to be challenging at best. The work required in order to undertake this exercise is likely to be disproportionate to the benefits to be gained from putting these generators onto the new charging regime. It would also appear to raise the issue of differential treatment dependent on the quality of paperwork that had been kept in connection with particular connections, or on how hard particular DNOs were willing to work on locating and processing historical data.

The other refund approach is to repay the current value of any access rights remaining at the time of switch over onto the new arrangements. This will require a forecast of the value of rights for all future years over which access was originally to be provided under the original arrangements. Again, this requires a lot of work to achieve a figure which will be highly likely to be wrong. A similar outcome can be achieved providing an exemption from the new charging arrangements until the previous rights expire. We note that this option has been discounted initially by Ofgem, but we are encouraged that you are willing to listen to arguments in favour of an exemption.

The benefit from putting pre 2005 generators onto the new charging regime has not been explicitly explained, but we suggest that exposing generators to new locational signals is only beneficial at the time that such generators seek to close or repower their generation plant. Therefore, we are uncertain that a refund approach which is likely to result in a lot of work for analysts and lawyers alike, with the associated cost, is likely to be proportionate to the result which is being sought. Exempting generators from charges for a period commensurate with the implied length of their generation projects would seem to be a pragmatic solution, which does not unduly undermine these pre 2005 investment projects but still allows them to be influenced by the locational signals within the GDUoS charge at the time when the project decides to close or repower.

We would also argue that it meets a number of the concerns raised by Ofgem regarding a bundled approach for compensation. The following issues in respect of bundled compensation arrangements should not be an issue with an timed exemption:

- It could be challenging to ensure that compensation is paid consistently when a methodology may change over time.
- It will be difficult to track when how much compensation has been paid to a particular customer and DNOs may still be exposed to the risk of accusations of undue discrimination.
- The Authority has to approve the charging methodology. This may present complications when Ofgem is also required to determine disputes over compensation.
- It may lead to very complex and detailed charging arrangements for DG which are difficult to understand.

We also note the concern about exposing all generators to the same price signals and to avoid undue discrimination. Firstly, we believe that this only an issue at the close or repower decision stage as mentioned above. Secondly, we believe that to apply an ongoing use of system charge to a generator who has already secured access through an upfront deep connection charge policy is in fact undue discrimination, unless some form of compensation or finite duration exemption is applied. Pre and post 2005 generators are clearly different so to expose them to the same post 2005 arrangements would be unreasonable.

Finally, Ofgem shouldn't see the imposition of such an exemption regime as a reversal of its initial decision to remove the previous exemption. That exemption was granted to all pre 2005 generators in the same manner with no consideration of the particular circumstances of individual projects. A project which connected in 2000 should not be given the same date for moving onto the new arrangements as an equivalent generator which connected before this. This is the fundamental difference between this proposal and the previous exemption. We would see the adoption of this option as the regulator addressing a difficult transitional issue in a fair and proportionate manner which would help to assure investors to potential investors that the GB has a suitable regulatory and market environment in which to invest.

I hope the above comments prove helpful. Please feel free to contact me on the above number should you wish to discuss any of these matters further.

Yours sincerely

Paul Jones
Trading Arrangements