ESB International
ESBI Energy Innovation

ESBI Investments, 3rd Floor, Regent's Place, 338 Euston Road, London NWI 3BT, England.
Tel: +44 (0) 207 544 8631 **Fax:** +44 (0) 207 544 8580 **Web:** www.esbi.ie

Ynon Gablinger
Distribution Policy
Ofgem
9 Millbank
London
SW1P 3GE

4th July 2011

Dear Ynon,

Electricity distribution charging methodologies: DNO's proposals for the higher voltages – ESBI response

ESBI welcomes the opportunity to provide comments on the proposals contained in Ofgem's consultation on "Electricity distribution charging methodologies: DNO's proposals for the higher voltages". As the owner of distribution connected generation assets, the outcome of this consultation and the introduction of the EHV Distribution Charging Methodology (EDCM) will have a material impact on our business.

This response provides a brief overview of ESBI, a summary of our views and responses to the questions contained in the consultation document and that affect our operations in the GB markets.

ESB International

In GB, ESB International (ESBI) has been a developer and operator of independent Combined Cycle Gas Turbine (CCGT) generation projects in the GB market for almost 20 years. We own, operate and trade Corby power station and developed the 850MW plant at Marchwood, which was commissioned late in 2009. We are also at an advanced stage with our latest 900MW development at Carrington which is due to become operational early in 2015. Additionally, we own and operate the 406MW Coolkeeragh plant in Northern Ireland. We are also developing further large-scale CCGT developments at other locations across GB.

In addition to increasing our conventional generation fleet, we continue to grow our position in the UK wind market. Our operational and development portfolio will be around 165MW by 2012, comprising: the 24MW West Durham Wind Farm in Northern England; the 20MW Hunters Hill; and 15MW Crockagarron

projects in Northern Ireland. Additionally, we are currently constructing what will be England's largest on-shore wind farm, at 66MW, at Fullabrook in Devon and we expect to start construction of our 38MW Mynydd y Betws Wind Farm in South Wales later this year. We are also active in the ocean energy sector.

Summary of ESBI views

We are strongly of the view that the Extra High Voltage Distribution Charging Methodology (EDCM) proposed by the distribution network operators' (DNOs), has failed to achieve many of the objectives set for it by Ofgem. We are disappointed that despite the original requirement by Ofgem, the DNO's have failed to develop a single use of system charging methodology. We find it difficult to understand how the FCP and LRIC methodologies can calculate different charges for the same customer whilst, at the same time, claim to be cost reflective.

We believe that the introduction of the EDCM should be delayed in order that a number of critical issues, that remain unresolved are addressed namely:

- Clarification of the charge calculation
- A lack of any detail on the proposed Grid Management Agreements
- The unresolved treatment of charging for pre 2005 connected DG
- The development of long term products, in order to reduce the volatility of charges.
- The interaction with Project TransmiT
- The fact that some customers will experience an immediate and significant increase in charges which may threaten the viability of their businesses and trigger unexpected plant closures. This could have unforeseen impacts for distribution network security

Foremost of our concerns is that, rather than producing transparent charges, the EDCM calculates charges using a black box that is based on the confidential investment costs of the DNO's. Whilst the methodology may be clear at a high level, the inability of customers to obtain the investment costs of the DNO's means they are unable to readily verify current charges or forecast future charges.

This lack of transparency means that it will be difficult to independently assess whether the EDCM accurately reflects the costs imposed on the network by users, facilitates competition or provide the necessary investment signals to help increase the connection of distributed generation. We would suggest that a practical solution to help improve transparency would be for the DNO's to produce and distribute a spreadsheet containing the necessary data that would then enable customers to calculate their own charges.

We have not yet received from the DNO's the terms and conditions relating to the proposed Grid Management Agreements. The services offered by DGs to DNOs under these agreements can result in an important reduction in the charges payable by DGs. To date, generators still have no information on the terms or services that will be required by the DNOs and how these agreements will interact with the commercial operations of the plant or existing system service contracts, for example Short Term Operational Reserve contracts (STOR). As such, we cannot properly assess the impact of the introduction of the EDCM charges until we have received these proposed agreements and had sufficient time to examine them.

Ofgem has recently closed a consultation on the compensation and charging treatment of pre-2005 Distributed Generators. ESBI has submitted a response to this consultation, rejecting Ofgem's view that pre-2005 connected DGs should pay EDCM charges as we are of the opinion that where DGs paid deep connection charges under previous regulatory arrangements, then they should continue to be exempt from paying Distribution Use of System charges for a period of time. The outcome of that consultation could have a material impact on the EDCM charges payable by all customers and as such we feel that accurate calculation of the new charges will not be possible until the resolution of the pre 2005 DG issue.

This consultation recognises that the new charging methodology is likely to give rise to year on year volatility in charges. For DGs with asset lives of at least 25 years, stability and predictability of future charges is essential in order to make rational investment decisions. Whilst we welcome Ofgem's proposal to require DNOs to develop measures to mitigate such volatility, including long term products, we have not received any indication on the form of these measures or products. In order to make an informed opinion on the impact of the EDCM, we will need to have at least an indication of what these proposed products or measures will contain.

Ofgem is currently conducting a review of transmission charges and associated connection arrangements under Project TransmiT. Proposals for transmission charges range from changing the locational element of the charge to removing it altogether, with an aim to better facilitate Government objectives for carbon reduction. As a large proportion of this new generation will be distribution network connected, it is likely that the outcome of Project TransmiT will have a significant interaction with the proposed EDCM. We believe it would be prudent for Ofgem to wait until the conclusion of Project TransmiT before implementing the EDCM in order to avoid any conflict with, or requirement for further change to,the EDCM.

A delay to the introduction of the EDCM will: enable the resolution of these critical elements; allow DNO's more time to clarify to customers the charging methodology; allow Ofgem to address the concerns raised in its consultation; and allow customers sufficient time to fully understand the new charging regime and take considered decisions on operation and possibly closure.

Responses to consultation questions

Below are ESBI's responses to a number of the specific questions raised by Ofgem in its "Electricity distribution charging methodologies: DNO's proposals for the higher voltages" consultation.

CHAPTER: Two

Question 2.1: What are your views on the key issues with the methodology we have highlighted? Are there any other issues or concerns with the methodology as a whole that we should consider?

In general, DGs provide a positive contribution to distribution networks by offsetting demand and therefore reducing or indeed removing, the need for network reinforcement and thereby reducing costs to end users. Taking to one side any additional DNO overhead costs, the actual costs imposed by DGs on the network are reflected in the charges calculated by the LRIC and FCP methodologies. We strongly disagree that these cost reflective charges are then subject to a scaling factor to bring revenue into line with the revenue target from generation for that DNO. This scaling factor is simply an uplift forcing generators to fund an arbitrary proportion of the DNOs revenue target rather than a true reflection of the actual costs that DGs impose on the DNO.

Secondly, whilst the high level principles of the EDCM appear clear, the actual calculations that underpin it are reliant on the DNO's investment costs of reinforcing the distribution network. This information has been deemed to be confidential to the DNO's. As a result, customers facing the EDCM charge have no easy means of calculating, independently verifying or forecasting the new charges.

Thirdly, we have real doubts as to whether the EDCM will provide the intended locational signals to DG investment. It is intended that the EDCM will provide DGs with signals to locate at the most economic and efficient places on the networks. By making a critical element of the charge "black box", DG is unable to readily calculate and therefore react to any inherent signal.

For some DGs, an integral part of the final charge that they will pay is a reduction associated with network benefits provided under generation management agreements. For larger DGs, the impact on charges of these agreements can be significant. We are particularly concerned that, as yet, we do not know the contents of these agreements and we are therefore unable to fully assess the impact of the introduction of the EDCM.

Question 2.2: Should we approve the methodology, do you agree with our proposal to implement it from full from 1st April 2011? If not, why is phasing-in charges or delaying implementation appropriate?

Given the issues detailed above we strongly believe that it would be most appropriate to delay the implementation of the EDCM, allowing customers a more orderly transition to the new charging methodology.

Implementation from the 1st April 2012 would place customers in a position of being obligated to pay charges that they are unable to calculate and verify themselves, given that they are largely based upon the DNO's investments costs, to which they have no access. In addition, it is questionable that customers will receive appropriate charges from the new methodology until the resolution of issues around: scaling, improving investment signals; detail on the grid management agreements; the volatility and unpredictability of future charges and associated development of long term products; and the treatment of intermittent generation on generation credits.

Finally, we feel that proposals for a phased implementation would be unworkable and very complex to implement. If phased on the basis of different types of customers or by different DNO areas it may produce arbitrary and possibly discriminatory decisions on which type of customers or which area of customers would benefit, as well as producing even greater volatility and unpredictability of charges during and at the completion of the phasing period.

CHAPTER: Four

Question 4.1: Do you agree with our proposal to modify the generation revenue target in order to avoid double charging for operations and maintenance costs on sole use assets? This issue aside, do you agree with our view that the approach to calculating a generation revenue target is reasonable?

We believe that the DNO's generation revenue should be simply determined by the LRIC / FCP methodology plus any apportioned DNO overheads, without the application of a generation revenue target and associated scaling of charges.

Question 4.2: Do you agree with our assessment that the approach to scaling is reasonable?

We do not agree that the proposed approach to scaling is reasonable; we believe that there is no need for a scaling factor to artificially adjust revenue from the LRIC / FCP calculation. The revenue raised solely from the LRIC / FCP charges in relation to DGs is a more accurate reflection of the actual costs imposed by the DGs on the distribution networks. As such, we see no need for a scaling factor or a generation revenue target.

The EDCM generation target does not reflect the costs (or savings) DGs incur on the distribution networks. We are of the view that it is an arbitrary uplift on DG charges and therefore cannot be cost reflective. Much time and resource has been expended developing the FCP and LRIC methodologies and we are unsure as to why the signals inherent in them should be removed or altered in the way the generation revenue target does.

Question 4.3: Do you think it is appropriate for only units exported by non-intermittent generators during the super-red time band to be eligible for credits?

We believe that it is appropriate and support the DNO's proposal that generation credits be restricted to units that are exported during the super red time period provided that the aggregate total of credit payments to generation is not lower relative to the situation where credits would be paid to DG for all units exported regardless of time of day or year.

By restricting the application of generation credits to units exported at "super red" times this will provide DGs with the appropriate incentive to generate at times of peak system demand when the network is most highly loaded. DG generally offsets this load, therefore deferring or removing the need for future reinforcement works and thereby reducing costs to end users.

Question 4.4: Do you agree with our proposal that intermittent DG should be eligible for credits as they are deemed to provide network benefits under ER P2/6? If they do become eligible for credits, should the credits only relate to units exported during the super-red time band or is a single credit rate to all units exported more appropriate?

We do not agree with Ofgem's proposal that intermittent DG should be eligible for generation credits especially if this is extended to a single credit rate for all units exported as this undermines the rationale for generation credits, whilst introducing another layer of unnecessary detail into an already overly complex charging methodology.

The purpose of generation credits is to incentivise and reward generation units produced at times of peak system load. Flexible and dispatchable generation can be relied upon to help offset load at such critical times and therefore helps to reduce the need for future system reinforcements. The point that increased diversity of generation contributes to system security is misleading when the key issue to security of supply is whether generation can be relied upon to generate when it is most needed to satisfy demand.

To create a separate system of generation credits for intermittent generation with a further sub division

into local and remote components, goes against one of key objectives of the EDCM regime namely to be transparent and for charges to be easily understood by customers.

Question 4.6: Are there any other generation specific issues that you think we should consider as part of our decision?

Our key issues is that charges should be reflective of the costs or benefits created by DGs on the distribution networks. Such charges are calculated by the LRIC / FCP methodologies, the generation revenue target and associated scaling factors arbitrarily remove this cost reflectivity.

Further, the overly complex nature of the EDCM combined with a lack of the necessary inputs of DNO's investment costs means that the EDCM model and its charges are opaque and impossible for users to independently calculate.

CHAPTER: Six

Question 6.1: Do you think sole use assets should attract scaling 'costs' to the same extent as shared assets? Does the charging rate on sole use assets seem reasonable given the nature of these assets?

We disagree with the need for any scaling and that charges applied to customers should simply be reflective of the costs those customers impose on the network. In line with this view we feel that a sole use asset charge for all customers and the revenue raised by it is a logical approach, reflecting the actual costs that customers incur on the network. As such we do not feel it would be appropriate to apply a scaling factor to these sole use assets.

In the absence of any scaling factor, the methodology for charging for these sole use assets appears to be reasonable.

Question 6.2: Do you agree with our view that the arrangements for demand and generation side management agreements are appropriate? Do you think such agreements should be available to all customers?

As we have not yet seen the terms contained in the proposed generation master agreements we have no knowledge of what it allows or precludes the DG from doing. As such, we are unable to assess its impact on the commercial operations of our plants, existing or future transmission system agreements or on overall security of supply. We would stress that these agreements cannot be considered in isolation.

The ability to negotiate demand and generation management agreements with DNOs should be open to all customers. However the ability to contract with the DNO on such agreements should depend on whether those agreements meet the demands of the DNOs, the terms are acceptable to generators and that the obligations and requirements placed on demand and generation customers under these agreements are certified in the same manner.

Question 6.4: On the proposal for sense checking branch incremental costs in LRIC:

- *Do you agree with our view that positive cost recovery (ie charges) and negative cost recovery (ie credits) should be considered separately?*
- *Do you consider that recovery from demand customers and recovery from generation customers should be considered separately?*

In relation to the proposal for sense checking of branch incremental costs in LRIC we agree with the DNO's proposals to examine positive recoveries and negative recoveries separately and to consider recovery from demand customers and recovery from generation customers separately.

In relation to the separate consideration of positive and negative recoveries this would appear to be a logical approach to deal with the anomaly where the total costs charged to users related to branch reinforcement exceed the actual costs of the physical branch reinforcement.

Regarding the proposal to look at recovery from demand and generation customers separately we believe that this approach more accurately reflects the contribution made by demand where it defers reinforcement and by generation where it defers reinforcement.

Question 6.5: Do you think the EDCM should include a mechanism to mitigate the potential volatility from network use factors? We welcome views on measures to mitigate volatility and help customers manage volatility.

One of the inherent problems of the EDCM is that it will produce volatile and unpredictable use of system charges. This will undermine investor confidence both on existing and future DG projects. We agree that

Ofgem should consider placing a requirement on DNOs to offer longer term charging products but it is essential that this is based on a fixed charge for the period of the product. Customers would then be free to make the commercial decision to opt for a “floating charge” that may go up or down each year or a “fixed charge” product that offers certainty for the term of the contract.

Generator revenues produced through generation credits and generation management agreements would be calculated separately to both the floating and fixed charge products.

Conclusion

We believe that the EDCM fails to achieve many of its stated objectives principally to establish a clear and transparent single charging methodology. Instead it produces an opaque black box model based on the confidential investment costs of the DNOs. The result of which, is that customers are left unable to verify or forecast charges.

There remain a number of critical issues that remain unresolved and are fundamental to the introduction and effective operation of the EDCM. As such, we feel it is best that Ofgem to delays the introduction of the EDCM in order to resolve these crucial issues.

Should you wish to discuss any of the points raised in this response further, please do not hesitate to contact me.

Yours sincerely,

Michael Dodd

GB Regulation Manager

ESBI Investments

Email: michael.dodd@esbi.ie