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Dear Nicholas,

Charges for pre-2005 Distributed Generators' use of DNO's distribution systems – ESBI response

ESBI welcomes the opportunity to provide comments on the proposals contained in Ofgem's consultation on "Charges for pre-2005 Distributed Generators' use of DNO's distribution systems". As the owner of distribution connected generation assets that connected prior to 2005, 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

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

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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

Distribution connected generators that connected prior to April 2005 were subject to a deep connection regime, whereby they were required to fund the full cost of connecting to the distribution system (including associated deeper reinforcement and operation and maintenance costs). We strongly believe that these costs should be refunded in the event that this class of generator is required to pay Use of System (UoS) charges and that Ofgem's proposed mechanism for providing this compensation is inadequate. Should compensation not be paid, it is our view that pre-2005 DG should be exempted from paying UoS charges for a period commensurate with the asset lives funded at the time of connection or the life of access right afforded in connection agreements.

The form of the connection agreements offered and signed by pre-2005 DG vary significantly from site to site with some clearly identifying the cost of the ongoing operations and maintenance charges, as well as inventories of assets provided or reinforced through deep connection charges. Other connection agreements, however, are, at best less defined, or in most cases appear to be silent on this issue. Moreover some connection agreements gave an explicit length of connection whereas other connection agreements are for an undetermined time period. The terms contained in these connection agreements were, at the time, standard agreements issued by the Distribution Network Operator (DNO) that the DG had little opportunity or ability to negotiate on.

Taking into account the complexity and variance of each DG's connection agreement, we are of the view that a pragmatic solution would be for those DG's that paid deep connection charges up front to continue to be exempt from paying UoS charges for the period afforded under the connection agreement. In the absence of an explicit connection length being contained in the connection agreement then the exemption from paying UoS charges should be based on the typical life of distribution assets starting from the date of first connection. At the end of this period each DG would then move on to the EDCM regime and pay the applicable charge.

In order to expedite Ofgem's stated objective for EDCM to introduce a common charging methodology across the country we are also of the view that there should be opportunity for DG's to agree to be subject to the EDCM regime with the understanding that that they would not then be able to 'opt back out' should the charges under the EDCM change.

At a time of significant regulatory change we believe that an exemption from paying UoS for those DG's that connected prior to 2005 and paid deep connection charges, combined with the opportunity for DG's to be subject to the EDCM regime should they wish, offers a more pragmatic solution to meeting both the DG's concerns and Ofgem's objectives for the EDCM, than that proposed in Ofgem's consultation.

Responses to consultation questions

Below are ESBI's responses to a number of the specific questions raised by Ofgem in its "Charges for pre-2005 Distributed Generators" use of DNO's distribution systems consultation.

CHAPTER: Three

Question 1: Is our description and interpretation of historical charging arrangements (including connection and use of system agreements, charging statements, determinations, regulatory precedents) complete and accurate? If not, please provide supporting evidence setting out any issues that you identify.

We do not agree that your interpretation of the historical charging arrangements is complete and accurate. We are strongly of the view that DGs that connected prior to 2005 paid deep connection charges that funded all necessary network investment and, in most cases, future operations and maintenance costs.

Connection charges and UoS charges were, at the time, one and the same thing and not separate items. Therefore, we strongly disagree with the consultation's stance that connection charges paid by the DG did not confer the right to use the system without further charges. To view that a DG would have paid for a system connection without the right to subsequently use that system is not a commercially logical assessment.

Whilst we are only privy to the terms of our own pre 2005 connection agreement and cannot comment on terms contained in the connection agreements of other parties in detail, it does appear that terms contained in agreements vary considerably and this should be better accounted for in Ofgem's proposals.

Question 2: Do you agree with our rationale for only allowing refunds for instances of double payment to be funded through the price control?

It is our view that wherever a DNO has had to pay legitimate compensation to a DG to avoid instances of double-payment arising from changes to connection agreements brought about through regulatory change instigated by Ofgem, then that DNO should be allowed to recover such compensation through the price control. Double payment is not limited solely to capitalised O&M charges and as such Ofgem should not limit refunds solely to these payments.

Question 3: Are there any other instances (beyond that of double payment) where refunds should be funded through the price control? If yes, please explain why these instances are appropriate and compatible with the regulatory regime as it has evolved over time.

This appears to overlap with Question 2 and we would refer to our answer to that question.

Question 4: Are there any other circumstances beyond capitalised O&M payments that may give rise to instances of double payment that should be reimbursed and funded through the price control? If yes, please explain why these instances are appropriate and compatible with the regulatory regime as it has evolved over time.

In the event that there is no exemption for pre 2005 DG from paying UoS charges, we believe that in addition to reimbursement of capitalised Operations and Maintenance charges, any deep connection charges used to fund reinforcement works should also be appropriately refunded and that those assets should be included into the DUoS charging base. This would ensure that there is no differential treatment between pre and post-2005 generators, and therefore avoids instances of discrimination that could arise under the Ofgem proposals.

Where pre-2005 DG funded connection and wider reinforcement costs up-front, irrespective of explicit provisions around capitalised O&M, we are of the view that for those DGs to be charged for the ongoing

use of the system without being adequately reimbursed for, at least, a proportion of those costs is inherently incorrect and (likely) discriminatory. Users that connected post-2005 have made use of, and therefore benefited from, the assets provided by individual DG under the preceding deep connection regime. For pre-2005 DGs to be required to pay UoS charges under the new regime appears to give rise to direct cross-subsidies between the two classes of generators (pre to post-2005 DG). We urge Ofgem to provide further clarification and robust justification as to why it believes this is not the case under its proposals.

Question 5: Do you agree with our proposed approach to calculating refunds for unexpired capitalised O&M payments? Please suggest any improvements to the approach outlined and reasons for these.

In general, we agree with the proposed approach to calculating refunds for unexpired O&M payments. However, we are of the view that there is significant detail still required as to how the principles will be applied. In particular, we note that many connection agreements will contain insufficient detail to facilitate the application of the proposed compensation requirements.

Whilst we agree with the rationale and formula used for calculating unexpired capitalised O&M payments it should be noted that, in some connection agreements, the period for which the capitalised O&M payment is intended to cover is not clearly defined and may simply be for the life of the asset.

Question 6: Where DNO's have entered into agreements that are/were inconsistent with regulatory practice (e.g. giving indefinite rights to use the system without further change or entering into contracts that cannot be freely modified) do you agree that any compensation required by virtue of these contracts should not be refunded through the price control?

Referring back to our answer to Question 2 we believe that wherever a DNO has had to pay legitimate compensation to a DG for changes to their original connection agreement, brought about through a regulatory change instigated by Ofgem, then that DNO should be allowed to recover such compensation through the price control mechanism.

We dispute the notion that certain DNO's entered into agreements that were inconsistent with regulatory practice. At the time, Ofgem had regulatory oversight of such connection agreements including the terms provided to DGs and chose not to raise any objections. We are therefore of the view that DG's entered

into these contracts in good faith with a reasonable expectation that such contracts were indeed consistent with the regulatory practice at the time of connection.

CHAPTER: Four

Question 1: In general are our proposals for implementing the refund arrangements considered by this consultation appropriate? Is the level of detail we have provided sufficient to make our proposals clear and workable? Please outline any areas where you think more clarity/detail is required.

Whilst Ofgem's proposals are clear on implementing the refund arrangements, we are unable to comment on whether they are workable given the diverse nature of each DG's connection agreement terms.

Question 2: In the section on "Consistent application of principles", have we appropriately identified who is eligible for a refund? Do we need to provide any further areas of clarification? Which of the two options outlined for mixed sites (demand and generation) are appropriate?

We agree with the principle that DNO's should treat all DG customers consistently in determining refunds. However given the considerable variations of terms in each DG's connection agreement then we feel this principle could be unworkable in practice.

Question 3: Are the evidence requirements set out in the chapter as necessary to support a case for refunding appropriate? Are they sufficiently robust to prevent ineligible claims for compensation being recovered through the price control? Are there additional or alternative assumptions that could be used for supporting a case for a refund?

Whilst we agree that that, where possible, explicit and specific evidence should be used to support instances of DNO's paying refunds, it should be recognised that a complete evidence base may not always be available. As we have previously stated, there appears to be significant variations in the terms agreed by the DGs in their connection agreements with the DNOs and as such we feel that supporting evidence may include independent legal opinion on such connection agreements.

Question 4: Is our approach to due process appropriate? Are there additional or alternative steps that should be incorporated?

Given that Ofgem has been the driver behind the introduction of the EDCM regime and proposed

compensation mechanism for pre 2005 connected DGs we believe that it is incongruous that Ofgem should also take on the role of dispute resolution between DNO's and DGs. A more legitimate and equitable method of dispute resolution, particularly given the potential for a large number of appeals, may be for the DNO and DG to seek independent legal arbitration.

Question 5: We welcome views on how refunds should be paid and the details of implementation. In particular, should it be a one-off payment, a phased payment or a hybrid of the two? If a refund is not a one off-payment, over what time period should it be paid? Do you agree with our proposals for refunds that are not agreed by 1 April 2012?

Our preference is for one off payments and feel that your proposal for refunds calculated after the implementation of the EDCM charging regime is a practical and workable solution.

Question 6: Do you agree with the mechanics for allowing DNOs to recover refunds through the price control?

Whilst we do not disagree with the mechanics contained in Ofgem's consultation we remain of the view that wherever a DNO paid legitimate compensation to a DG then that DNO should be allowed to recover such compensation through the price control mechanism.

Question 7: Do you agree with our proposals for dispute resolution where DNOs and DGs cannot reach a settlement by 1 April 2012? How can we encourage DNOs and DGs to reach a timely settlement? In particular, should use of system charges in respect of the DG be logged up and back-billed once a refund has been settled on? If these DGs do not have these charges back-billed, how should these charges be recovered by the DNO from other customers?

As per our answer to Question 4 above, we believe that in the event of dispute resolution being required, a more legitimate and equitable approach may be for the DNO and DG to seek independent legal arbitration. In addition, given the potential for a significant number of appeals we feel that it may be more efficient and timely to resolve disputes between DNOs and DGs by independent legal arbitration than to potentially overload Ofgem with the large number of appeals it will undoubtedly receive.

With regards the proposal contained in para. 4.50 for the logging up of charges and back-billing DG in the

event they become liable for UoS charges, we feel this is a pragmatic solution to the issue of protracted dispute resolution.

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

Yours sincerely,

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