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Your ref 58/11

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Dear Nicholas

Charges for pre-2005 distributed generators' use of DNO's distribution systems – Proposed Guidance

RWE npower welcomes the opportunity to comment on these proposals. This response is provided on behalf of the RWE group of companies, including RWE Npower plc, RWE Supply and Trading GmbH and RWE Npower Renewables Limited, a fully owned subsidiary of RWE Innogy GmbH.

We support the joint response submitted by the RUK, REA, CHP and AEP trade associations.

Impact Of Charges

We believe that pre-2005 distribution-connected generators should not pay GDUoS charges until the end of life of the generation assets. We are particularly concerned by the effects of the regulatory uncertainty that any retrospective change prior to this time would cause. A decision to apply charges only at the end of a project's asset life would be in line with other regulatory decisions to recognise and grandfather existing contractual rights. Our investors have indicated that increased regulatory uncertainty in the sector is likely to deter future investment and increase the cost of borrowing. Therefore, we also believe that recognition of existing contractual rights is essential to facilitate future investment in renewable projects. Pre-2005 distribution-connected generators did not know that use of system charges would later be charged retrospectively and therefore could not factor such charges in their economic evaluation and location decision of such projects. Existing investors in pre-2005 connected distribution connected generation projects expecting a certain level of return will see their margins severely affected by this change. In particular, this will make the renewables sector less attractive to investors at a time when the government is looking to develop numerous renewables projects in order to meet challenging climate change targets.

This proposal would be relatively simple to implement and has the desired economic effect of subjecting all generators to GDUoS charges at about the time that they may be considering closure. Subjecting generators to GDUoS charges before the time at which closure is being considered, performs no useful economic purpose because generators cannot react to the price signal provided. Such action may cause plant to close early, which could in turn affect security of supply and the economic efficiency of the network in general.

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If GDUoS charges were not applied to pre-2005 connected DG retrospectively, it would not be necessary to offer refunds. If Ofgem does decide to go ahead with these proposals, we believe that pre-2005 should be offered full compensation for the loss of contractual rights and additional costs imposed. We also believe that Ofgem should consider introducing appropriate measures for those most severely affected by the changes to operating costs of individual projects by introducing phasing or delaying the introduction of the charges to some sites such projects include transmission connected DG.

We do not believe that the existing arrangements are discriminatory since pre- and post-2005 generators are clearly very different. Pre-2005 connected Distributed Generators have paid essentially a deep connection charge and this is reflected in the charging regime by in effect setting the charge to zero (ie the costs are sunk and excluded from the regulatory asset base). Post -2005 connected Distributed Generation pay a cost reflective charge which reflects the inclusion of the connection assets in the regulatory asset bases. In both cases the charges recover the costs of the connections. We are concerned that applying on-going use of system charges to a generator who had already secured access through an upfront deep connection charge would be discriminatory. We also note that we are not aware of any calls from the industry amongst post-2005 connected asset owners to change the existing arrangements.

We are also concerned that the administrative and legal costs which would be associated with introducing this change may far outweigh any perceived benefit. Ultimately, if these changes were implemented, we are concerned about the consequential impact on the bills of the end user. In addition, we do not believe that the administration and legal costs for DNO's should be recovered from Price Control Revenues.

Embedded Large Power Stations

We remain concerned by the effect that these proposals will have on embedded large power stations what are deemed to be using the transmission system. The consultation does not appear to address this issue, and specifically, takes no note of the pancaking of charges issue that occurs as a result.

Under the terms of their connection agreement with the DNO, all embedded Large Power Stations as defined in the Grid Code are required to enter into a bilateral agreement with National Grid Electricity Transmission plc. A Large Power Station is defined as being above 100MW capacity in England and Wales, above 30MW capacity in Scottish Power's area, and above 10MW in Scottish Hydro's area. The main purpose of these agreements is to ensure compliance with the technical requirements of the Grid Code relating to Large Power Stations, particularly the provision of services such as frequency response and reactive power required to support the transmission system, and to pay transmission network use of system (TNUoS) charges where applicable.

Embedded power stations above 100MW are licensable and subject to TNUoS charges, based on the capacity of the power station and the charging tariff applicable to the transmission zone to which the power station is connected. In deriving these charges, it is assumed that this size of power station is effectively exporting its entire output onto the transmission system. As such, they are treated as if they were transmission connected and do not qualify to receive embedded benefits that would otherwise be credited to an exempt embedded power station under the terms of the BSC

Given the recognised impact of Large Power Stations on the transmission system and the requirements to provide technical services to support the transmission system, it is questionable to what extent, if any, this category of power stations should be exposed to distribution charges. For Large Power Stations above 100MW, who do not qualify for embedded benefits and are subject to transmission use of system charges, the argument that they should not then be subject to the pancaking of distribution use of system charges is more compelling. It would be unacceptable to pancake both GDUoS and TNUoS charges on this category of power station and we would therefore expect that such power stations would be exempt from GDUoS charges (in a similar manner to Interconnector Users being exempt from TNUoS charges). In addition, we believe National Grid are looking to levy TNUoS charges on sub-100MW DG and therefore this post-2005 category could also be subject to pancaking of TNUoS/GDUoS.

As part of an iterative process including the geographical siting decision, a developer may apply to the relevant licensee for either a distribution connection or a transmission connection. The choice of connection

may be obvious in many cases but, for schemes in the approximate range 200MW to 500MW, the developer may have a choice whether to apply for a transmission or distribution connection. Whilst the initial capital cost of a transmission connection may be more expensive than an equivalent distribution connection, with the introduction of GDUoS charges it is less likely that this category of power station would opt for a distribution connection in preference to a transmission connection. It is therefore important that the proposed distribution charge levied on this category of power station does not inefficiently distort the choice of connection in favour of transmission, leading to an increased overall cost to the consumer.

We would request Ofgem to confirm their position on large embedded power stations, and, in particular, how the issue of pancaking of charges will be resolved.

Power Station location

For pre-2005 power stations subject to use of system charges, the siting decision would be based on the expectation that no distribution use of system charges would be payable and, should a distribution connection be chosen, the final location choice would have sought to minimise the transmission use of system charge and also extent of the any distribution network reinforcements. It is unlikely that this previously determined location and connection of the power station would be the same as that which chosen under the proposed arrangements. With the potential introduction of distribution charges, the generator is faced with an additional charge which may be significantly greater than the existing transmission charge over which it has no influence and had no opportunity to respond to.

Evidence required to support the recovery of refunds through the price control

The value of refunds which will be recovered through the price control should be made visible to suppliers and other market participants on an ongoing basis in order to ensure that the impact on future DNO tariffs is predictable.

Questions in the Consultation

Despite our strong opposition to the retrospective introduction of GDUoS charges for pre-2005 connected Distributed Generation and without prejudice to our overall position, we have provided comments in response to each of the questions set out in the consultation document. This is attached. We believe that it is important for us to provide these comments in order to mitigate the impact of these proposals, if Ofgem decide to proceed despite the serious concerns raised by the industry.

In summary

- We are concerned that the introduction of on-going use of system charges to an embedded generator who had already secured access through an upfront deep connection charge would be discriminatory.
- We consider that embedded renewables and embedded generators will be most affected by these proposals and that all of the issues raised in our response would be best addressed by an exemption of GDUoS charges for pre-2005 connected DG until the end of their asset life.
- The regulatory uncertainty caused by the decision to retrospectively introduce GDUoS charges for pre-2005 connected DG will reduce the investment appetite in the sector and increase the cost of borrowing.
- We are concerned that the administrative and legal costs which would be associated with introducing this change far outweigh any perceived benefit. Ultimately, if these changes are implemented, we are concerned about the consequential impact on the bills of the end-user.

- Impacts on DNO revenues in the next price control should be made transparent to suppliers and other market participants on an ongoing basis in order to ensure that the impact on future DNO tariffs is predictable.
- We believe that Ofgem should consider separately the impacts on embedded renewables and embedded generators when forming its final policy implementation decisions. We would ask Ofgem to confirm their position on how to best address the issue of pancaking of charges for large embedded power stations.

Please feel free to contact me if you wish to discuss this response in more detail. This response is not confidential.

Yours sincerely,

By email so unsigned

Helen Inwood
Network Charging Manager

(Attached – RWE npower's response to questions in proposal document)

RWE npower's response to questions in proposal document

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 believe that Ofgem and Distribution Network Operators are the most appropriate parties to answer this question as opposed to the pre-2005 generator. We do not agree that pre-2005 generators acted against regulatory practice by signing contracts which did not require them to pay ongoing use of system charges. Such generators had little choice but to connect under the arrangements which were prevalent at the time. Pre-2005 DG had very little control over the terms of the contracts that they signed pre-2005 and, in the absence of any other issues with the connection offer, would have been unlikely to refer the particular terms to Ofgem for determination.

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

We believe that pre-2005 connected DG should be compensated for loss of contractual rights as well as all up front costs, including O&M and deep connection charges.

The principles are not correct because those generator that paid upfront connection charges would now have to pay a proportion of the socialised cost of everyone else's connection costs so they would be paying twice for connection costs.

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.*

Unless pre-2005 connected DG is adequately compensated, the increased risk of regulatory uncertainty perceived by investors will reduce the availability of finance in general and increase the cost of borrowing for future projects. Therefore we believe adequate compensation should be offered through the price control or GDUoS charges should be deferred for pre-2005 connected DG until the end of their generation asset lives.

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.*

We believe that upfront connection charges, O&M charges and any other charges should be funded through the price control, if there is no other form of compensation open to the DNO. Unless the regulatory regime recognises contractual rights, the risk profile of the sector will increase significantly.

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.*

Further information should be supplied to explain what constitutes O&M charges and the appropriate discount rate to be used in the calculation, where the rate for the original capitalised payment is not specified in the contract. We believe that any ambiguity could result in refunds not being paid by the DNOs because of the risk that they will not be refunded through the price control.

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

We believe that contracts which gave such rights were consistent with the regulatory practice which was in place at the time the contracts were issued. Under contract law, we believe that those rights should continue for the duration of the contract even if they were not explicitly stated because of the legitimate expectation inferred. If the contractual terms are altered, generators should be paid adequate compensation. As a general principle, we agree that the DNO should not recover additional compensation payments through the price control since they have already received payment at the time of receiving the deep connection charge. However, we are concerned that generators may be less likely to receive compensation if the DNO's cannot recover this through the price control. As a result, we would recommend that all compensation claims should be looked at by Ofgem on a case by case basis.

DNO's legal and administration costs should not be funded through the price control.

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.*

Further clarity is required in a number of areas including the discount rate to be used in the model and the definition of O&M.

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?*

In our experience, it is very difficult for DGs to negotiate their contractual terms prior to signing a connection agreement and therefore, we do not believe that DGs would be in a position to unilaterally change their contracts. We believe that DG should be compensated for changes to contractual rights because it would be highly unlikely to be able to successfully negotiate any contractual changes bilaterally and impossible to change them unilaterally.

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?*

We believe the risk of not providing adequate compensation is higher than the risk of overcompensating generators under these proposed arrangements.

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

We believe that the impacts on all parties should be adequately considered, including the impact on investors in the renewables sector.

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?*

We believe that there may be tax implications to receiving a lump sum. This would mean that we received less compensation than our entitlement. We therefore consider that phased or delayed implementation of the charges would be most appropriate.

We do not believe that DNOS should be forced to resolve refund claims within any specific time limit. This is likely to less robust decisions being made which are more likely to lead to subsequent appeals.

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

We do not think that the price control is an appropriate mechanism for funding refunds because of the need to recover the cost from all network users through the GDUoS charges. In effect this will mean that generators entitled to receive compensation will need to pick up a proportion of the costs through their GDUoS charges.

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?*

We do not believe that DNOs should be forced to resolve claims for refunds within a specific timescale. The contractual terms vary significantly between generators and the process is likely to be lengthy and complex.