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Dear Guy,

Consultations on the treatment of generation under EDCM and on the proposed time limited exemption for pre 2005 generators

Thank you for the opportunity to comment on the above issues. E.ON is particularly supportive of Ofgem's proposal for a time limited exemption for generators who connected to distribution networks prior to 2005. As you know, the possibility of charges being applied to these generators was the cause of some considerable concern within the generation industry. It is very encouraging to see that Ofgem has considered the points made by the industry and decided that a time limited exemption might be appropriate.

Of course, the proposals are not totally as we believe they should be. We appreciate a 20 year exemption may sound like a considerable length of time, but this is still shorter than the expected life of many power stations. Nevertheless, a 20 year exemption is a considerable improvement compared with pre 2005 generators being exposed to charges immediately without compensation. We therefore still welcome the proposal as presented in the consultation paper.

Our detailed responses to the questions posed in both consultations are as follows.

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Consultation 1 - Distribution use of system charging: a time-limited exemption for pre-2005 generators

Question 1.1: Do you agree with our proposal that by default eligible CDCM generators should continue to be charged for UoS and that eligible EDCM generators should continue be exempt from charges, unless either party chooses otherwise?

Yes. We agree that a time limited exemption should be available to pre 2005 generators on both methodologies. However, given that most CDCM generators are likely to opt for paying charges as they are currently negative, the most pragmatic approach is to allow them to opt into the exemption. Of course, this relies on all generators being fully aware of their options in this respect and having a full set of information available to them in order to allow them to make that choice effectively.

Question 2.1: Do you agree that a time-limited exemption should be set on an ex ante basis?

Yes. This is the most pragmatic solution. It is a simple option which continues to honour the access rights that generators believed they were getting when they connected under the previous deep connection charging policy. It also is the option most suited to dealing with the somewhat patchy data that exists regarding the exact terms under which some generators connected, such as the payments made for network reinforcement. This will also provide certainty to both generators and DNOs alike, who will know up front the period of time that the exemptions will run for and therefore the date on which they will expire, and will assist the commercial operations of both sets of parties.

Question 2.2: Should an exemption be calculated from the date of a pre-2005 DG 's connection, rather than some other date, such as from the date at which EDCM DG charges are introduced? Why?

The basic principle should be that the exemption should be calculated from the date that the generator started receiving access to the distribution network in order to export electricity and sell it on to suppliers/customers. Please see our response to question 3.4 which touches on this issue further.

Question 2.3: Do you agree with our assessment of the options for determining the time limit for an exemption? Are there additional points of analysis we should bear in mind?

Question 2.4: Are there better alternative options to those which we set out in this chapter and what would be their rationale?

Question 2.5: Do you agree with our initial thinking that a 20 year limit is appropriate? If not, what might be a more reasonable period of time that balances the interests of pre-2005 DGs and the DNOs ' other customers? Please explain the reasoning behind your answer and provide any associated evidence.

The assessment of the options appears sensible. However, we do not fully agree with the conclusion that the Authority has arrived at in that a 20 year access right would be most

appropriate. We believe that it would have been reasonable for pre 2005 generators to expect that access was acquired for the life of their generation projects. We do not necessarily believe that the length of access right has to be tied to the replacement life of distribution assets, even if these have been paid for by some generators in the upfront costs that they paid for network reinforcement, as this in many cases would be greater than the lives of the projects utilising the assets.

If the access right was to be granted on the basis of it representing the average life of a generation project, it may have been more appropriate to arrive at different lengths of exemption dependent on technology type of the generators concerned as this clearly differs, as illustrated by the analysis on page 18 of the consultation document. If a generic length of exemption is to be defined across all generation types, then we believe that the analysis shows that a length of 25 years to 30 years would have been more appropriate. We do agree, however, that the exemption length should not be ascertained on a case by case basis, except in clear exceptional circumstances. One of the purposes of the exemption route is to create a mechanism which is easy to administer and non discriminatory. Such a case by case approach would negate this benefit to a certain extent.

Question 2.6: We note that rather than pay a capitalised payment for O&M, some DG customers pay an annual charge for O&M. Where such a DG is eligible for an exemption, should they continue to pay their annual O&M charge?

Yes. What we are seeking is for generators to receive the same commercial terms under which they originally signed up. Therefore, if a pre 2005 generator is presently paying an annual charge for O&M, then it should continue to do so on the same basis. However, were the basis of calculation of this charge to change significantly then it would be appropriate to reconsider this approach.

Question 3.1: 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 and set out your suggestions for what might fill these gaps.

Question 3.2: Is our approach to due process appropriate? Are there additional or alternative steps that should be incorporated? What is a reasonable period of time in which to complete the due process we propose?

These seem reasonable. As we mention in our answer to question 1.1, it is very important that generators have sufficient information with which to make the decision about whether or not to opt for the exemption or to pay charges. In the second of the two consultations, options are presented as to how the current proposed EDCM methodology could be improved before implementation in 2013. In order that generators are able to make this choice, this work has to be concluded so that indicative tariffs are available to them.

Question 3.3: Do you agree with our proposals for dispute resolution where DNOs and DGs cannot reach a settlement by 1 April 2012?

In the consultation is explained that disputes over new or amended connection terms would be a matter for Ofgem to determine under the Act. We agree, but would question whether this would always be applicable in disputes about whether or not the charge exemption would be valid, or if so for how long etc. In circumstances such as these using the Electricity Arbitration Service may be more appropriate.

Question 3.4: Do you agree that the connection date should be the date from which the exemption is calculated, with the energisation date used if the connection date is not available? Or, would it be more straightforward simply to use the energisation date for all eligible DGs?

As we mention in our response to question 2.2, we consider it important to run the exemption from the date from which the generator's access right commenced and it was able to export power onto the distribution system in order to sell it onto suppliers/customers. This definition of this date is likely to differ by agreement, dependent on when it was signed and which DNO was the counterparty. It is probable that a standard approach can be adopted for many agreements. However, for some instances there are likely to be disagreements as to the exact relevant date, which presumably can be resolved through the disputes process.

Question 3.5: Similarly, should a pre-2005 customer with a mix of demand and generation requirements be eligible for an exemption from UoS charges?

Yes. Such a generator should be able to opt out of export charges, but should presumably continue to pay charges for imports.

Question 3.6: Do you agree with our proposal that the introduction of UoS charges should happen from the beginning of the next charging year after the date on which an exemption ends?

Yes, this means that issues regarding the exact date from which an exemption commences are likely to be less material and will ensure that generation coming to the end of its exemption can be added to the use of system charging base within the usual charge setting timescales.

Consultation 2 - Distribution use of system charging: way forward on higher voltage generation charging

Question 2.1: Option 1 – Do you think that charges more or less appropriately reflect costs imposed by DG, following the removal of (some or all) pre-2005 DG?

This option simply applies the EDCM methodology as if pre 2005 generators had not been included from the start. There is nothing inappropriate about this although we accept that the EDCM methodology in itself may be open to question with respect to its application to generators. Therefore, we believe that option 2 also has merits.

Question 2.2: Option 2 – Do you think it is appropriate to include a generation-led reinforcement (locational) charge? What are the advantages and disadvantages of removing such a charge?

We believe that the generation led reinforcement charge is problematic as currently structured. We support locational charging, especially on the transmission network. However, the issue with its application to distribution networks and in respect of generators in particular is that the addition or subtraction of a relatively small amount of generation to a distribution network can have a significant effect on the charges compared to the similar position on the transmission network. This can make the charges highly volatile.

Volatility is not a problem in itself as long as there is something that a party can do to manage it. On the transmission network, it is possible to model the effects of changing demand and generation patterns using the charging model which is made available by National Grid. No such equivalent models exist for the DNOs.

Therefore, we believe that there is some merit in the idea of removing the generation led reinforcement charge, especially as some locational signal will be provided by the demand credit. However, we also believe that this credit should be applied to all generation in relation to their output in super red periods. Therefore, if intermittent generation are available during those periods, they should be rewarded too.

Question 2.3: Option 2 – This option may result in increased charges for generators currently in demand-dominated areas of the network, compared to those predicted under the EDCM. However, this could be matched by a decrease in potential volatility. What are your views on this potential trade off?

This is clearly going to come down to the specific circumstances of individual generators. However, as a general principle this seems to be an appropriate approach to take.

Question 2.4: Option 3 – Do you think that the EDCM should continue to calculate charges as if all generators continue to be charged? What is the reasoning behind your response?

No this is not correct as this is not what is happening in reality. The charges should be calculated with the pre 2005 generation outside of the calculation until any exemption has expired. Of course this means that the £1/kW which is being assumed for exempt generators should be removed from the generation revenue target. It would not be right to expect this to be funded by non exempt generators especially if exempt generators continue to pay an O&M charge, or have already done so through a capitalised payment.

Question 2.5: Option 4 – Is it appropriate for EDCM generators to recover their share (based on their capacity relative to CDCM) of the DG incentive revenue (ie 80 per cent of generation-led reinforcement costs plus £1/kW incentive revenue)? If not, how should this incentive revenue be recovered?

We are fairly relaxed about this option. Recovering actual costs without the £1/kW representing 20% of the costs would be more reflective of actual costs incurred, although the revenue that would be paid to DNOs would be different.

Question 2.6: Option 5 – Do you think it is better to revisit the methodology more fundamentally?

Although there is still some discomfort about the EDCM methodology in the generation industry, the approach of introducing incremental change appears sensible at this point. This view may evolve as the work to implement any changes progresses.

Question 2.7: Option 5 – What cost signals do you think generators have the ability to respond to?

Generators can respond to different cost signals by making decisions to locate and close their plant, and by changing the manner in which that plant is operated. The key issue is to ascertain what behaviour you want to influence and design the signal accordingly. Of course in order for desirable behavioural change to occur, the generator has to understand and predict how its behaviour will change prices. As we mention above, there are some concerns that the present design of the EDCM methodologies makes it difficult for generators to do this.

Question 2.8: Do you have any other suggested modifications to the proposed methodology?

No.

Question 2.9: Which of the options (if any, or including a combination) do you think would enable the EDCM for DG charging to fulfil the Relevant Objectives set out in the licence after the removal of exempt generators? Why?

From our response to the questions above, we believe that option's 1 and 2 could be considered together (keeping pre 2005 out of the charging process and removing the generation-led reinforcement charge. We do not have a strong view on option 4 which could be incorporated if necessary.

Question 2.10: What is the most appropriate way of redistributing the unrecovered revenue from exempted generators to other users of the network?

Yes, but we wouldn't describe it in those terms. We believe that the methodology would simply be reverting to that which would have existed had pre 2005 generators not been in scope.

Question 3.1: Do you think EDCM charges for non-exempted generators should apply from 1 April 2013? Why?

Yes, this is really the first date at which it could be feasibly introduced once the necessary changes had been considered, consulted on and developed into final methodologies.

Question 3.2: Do you agree that the boundary change for generators should be deferred to coincide with the implementation of EDCM generator charging? Why?

Yes, it would seem to be the approach which delivers most certainty to generators. We do not believe that it would be helpful to introduce it for an intermediate period.

Question 3.3: Do you have any comments on the suggested timetable for the reconsideration and subsequent approval of EDCM charges for DG?

If it is adhered to then the timetable set out seems appropriate. As we mention above, it is important that pre 2005 generators in particular understand the implications of their choice of whether or not to opt for an exemption. Therefore, they need to know what sort of prices they are likely to be exposed to under the new charging regime in sufficient time to do so.

I hope the above views prove helpful. Please contact me in the first instance should you wish to discuss these issue further.

Yours sincerely

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Trading Arrangements