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Guy Donald
Ofgem
9 Millbank
London
SW1P 3GE

1st December 2011

Dear Guy,

Reference: 134/11 Distribution use of system charging: way forward on higher voltage generation charging.

ESBI welcomes the opportunity to provide comments on the proposals contained in Ofgem's consultation "Distribution use of system charging: way forward on higher voltage generation charging". As the owner of both pre-2005 and post-2005 distribution connected generation assets, the outcome of this consultation and the proposed introduction of the time-limited exemption for pre-2005 generators 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 have recently completed construction of 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 early next year. We are also active in the ocean energy sector.

Summary of ESBI views

We welcome this consultation and the proposed deferral of the decision on EDCM generation and believe Ofgem has made the correct decision to reassess the impact of the time limited exemption for pre-2005 generators upon the DNO's other customers, as well as looking to address the issue of the volatility and unpredictability of the EDCM regime.

In our response, of the 4th July 2011, to the Ofgem consultation "Electricity distribution charging methodologies: DNO's proposals for the higher voltages" we highlighted our principle concerns to the introduction of the EDCM regime. In summary our concerns focused on the following issues:

- The use of a scaling factor to bring revenue into line with the revenue target from generation for that DNO. Rather than reflecting the actual costs that DGs impose on the DNO, this scaling factor is simply an uplift forcing generators to fund an arbitrary proportion of the DNOs' revenue target.
- The overall complexity and lack of transparency of the EDCM regime. Particularly, that the information on the DNO's investment costs that is used to calculate the EDCM charges are confidential to the DNO's. As a result, customers have no means of calculating, independently verifying or forecasting the new EDCM charges.
- The potential for increased volatility of charges to DGs.

In addition, we also raised concerns on: a lack of any detail on the proposed Grid Management Agreements; the unresolved treatment of charging for pre-2005 connected DG; the interaction with Project TransmiT: and the fact that some customers will experience an immediate and significant increases in charges which may threaten the viability of their businesses and, subsequently, security of supply

We believe that our concerns and issues on the EDCM (detailed above), can be best resolved through the removal of the generation led reinforcement charge (Option 2). We would also seek the removal of the use of the generation revenue target under Option 5 in order to improve cost reflectivity. However in the event that a generation revenue target were to remain part of the EDCM then we would much prefer for it's calculation to be based upon Option 4 which we feel is more cost reflective of the actual costs created by DG's on the network.

We hope that this consultation and the associated delay to the implementation of the EDCM for generation customers will allow Ofgem the opportunity to redress our, and other generators concerns, so as to produce an improved extra high voltage charging methodology that is more cost reflective, more transparent, simpler and less volatile.

Responses to consultation questions

Below are ESBI's responses to a number of the specific questions raised by Ofgem in its "Distribution use of system charging: way forward on higher voltage generation charging" consultation.

CHAPTER: Two

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?

Whilst it is possible to see in Table 2.1 the impact of the removal of pre-2005 generators on the total recovery by DNO's from post 2005 DGs, it is not possible for us to comment on whether the charges appropriately reflect the costs imposed by DGs, as we would need to see the costs on an individual site by site DG basis.

We are also concerned that Option 1 does nothing to address our primary concerns on the EDCM, namely the application of an arbitrary scaling factor; the inherent complexity and lack of transparency in the EDCM calculation; and the future volatility of charges

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?

No, we do not believe it is appropriate to include a generation led reinforcement charge. As a result we are generally supportive and in favour of Option 2, namely the removal of generation led reinforcement charges. Option 2 will likely reduce the future volatility of charges and allow DNOs to provide better forecasts of future charges.

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?

We are aware that Option 2 may indeed result in increased charges for DGs in demand dominated areas but feel that this would be offset by the benefits of reduced future volatility of charges and a more predictable charging methodology.

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?

We do not support Option 3, namely to continue to calculate charges as if non-exempted generators are charged with the shortfall in revenue recovered from EDCM and CDCM demand customers. Whilst this maybe the simplest option to implement, we feel it does not represent a fair balance of cost distribution for all of the DNO's customers in both generation and demand, and under EDCM and CDCM. In addition, Option 3 does not address our primary concerns over the EDCM.

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 (i.e 80 per cent of generation-led reinforcement costs plus £1/kW incentive revenue)? If not, how should this incentive revenue be recovered?

No, we do not believe it is appropriate for EDCM generators to be charged based on an arbitrary share of the DG incentive revenue based on the model of 80 per cent generation-led reinforcement costs plus £1/kw incentive revenue.

Although we object to the use of a scaling factor and a generation revenue target as not being cost reflective, if such a generation revenue target were to remain then we are of the view that Option 4 better reflects the costs that DGs impose on the distribution networks. In this case, our strong preference would be for Option 4 to be used in conjunction with Option 2.

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

Whilst in theory we are supportive of revisiting the entire methodology, due to the principal concerns over the EDCM that we have discussed previously in this response, we also recognise that in practice this would be hugely disruptive and would have a significant adverse impact on investor confidence (both for DG and demand customers). As a result, we do not believe fundamentally revisiting the entire methodology is a realistic proposition.

Nonetheless, we would strongly support further consideration on the necessity for a generation revenue target. We believe that there is no need for such a target and that the revenue raised from DGs should simply be reflective of the costs imposed by such generators upon the distribution network.

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

In our view, the cost signals faced by generators in relation to network charging are: the one off locational signal on where should the DG be built; the ongoing operational signals over time of use; and cost of constraints. Clearly, once a DG has been constructed it is only the ongoing operational cost signals that DGs are able to respond to.

The cost signals that are most important to DGs are stability and transparency. DGs recognise that changes to generation and demand capacity in their local DNO area are inevitable and as such charges will change over time. It is essential, however, to ensure that volatility is reduced so that charges do not change radically from one year to the next.

General

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

We have no further suggested modifications to the proposed methodology.

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?

We do not support the introduction of any of the individual options contained within the consultation. Instead our favoured position would be for an EDCM based upon Option 2, combined with Option 4 and containing elements of Option 5 namely the removal of the generation revenue target and publicised guidance from DNO's on where to best locate future DG.

We are firmly of the view that this combination would result in an EDCM that is: simpler; more transparent; significantly less volatile; more cost reflective; and would better meet the objectives of the methodology.

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

Considering the net benefits that DG brings to distribution networks, the most appropriate and pragmatic means of dealing with the unrecovered revenue from exempted generators would be to recover it from the DNO's demand customers.

CHAPTER: Three

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

We believe that EDCM charges should only apply to non exempted generators once the concerns and issues raised in this consultation have satisfactorily been resolved. In our opinion it should be entirely feasible to resolve these concerns and issues in time to implement EDCM charges for non exempted generators by the 1st April 2013.

However, in the event that it is not possible to resolve these outstanding issues by the 1st April 2013, then we are firmly of the view that it would be preferable to delay the introduction of EDCM charges by a further year. This is because it is essential to avoid the implementation of EDCM charging that is only partly agreed and subject to further changes, as this would only serve to undermine investor confidence and the credibility of the EDCM regime.

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?

We agree that it would be sensible to delay the boundary change that would bring high voltage generators currently under CDCM onto EDCM, until the implementation of the EDCM generator charging has taken place.

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

In line with our previous response we believe that although an implementation date of the 1st April 2013 is feasible, in the event that the concerns and issues raised in this consultation are not resolved then it would be preferable to delay the implementation of EDCM charges for generators.

In addition, we would suggest that DNO's should provide indicative EDCM charges to all DGs as soon as practicable after Ofgem makes its decision on the EDCM. This is particularly important for the pre-2005 generators in order that they can make an informed decision as to whether they wish to exercise their exemption from paying DUoS charges or to opt into to paying charges under the EDCM.

Conclusion

We welcome this consultation and believe that it provides the opportunity to allay the concerns of stakeholders surrounding the introduction of the EDCM. We hope and believe it is entirely possible to make and achieve these improvements to the EDCM for implementation on the 1st April 2013.

Our strong preference is for an EDCM based upon Option 2, which would see the removal of generation led reinforcement charges. We would also seek the removal of the generation revenue target as we do not believe such arbitrary adjustments can be cost reflective.

Lastly, in the event that a generation revenue target were to remain as part of the EDCM then we firmly believe that the calculation should be in the form suggested by Option 4, which we think would improve the cost reflectivity of the EDCM relative to the status quo as well as making it more transparent.

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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