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Guy Donald  
Ofgem  
9 Millbank  
London  
SW1P 3GE

2nd December 2011

Dear Guy,

**Reference: 135/11 Distribution use of system charging: a time limited exemption for pre-2005 generators**

ESBI welcomes the opportunity to provide comments on the proposals contained in Ofgem's consultation on "Distribution use of system charging: a time-limited exemption for pre-2005 generators". As the owner of both pre-2005 and post-2005 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 that affect our operations in the GB markets.

**ESB International**

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 projects 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 have recently completed construction of England's largest

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on-shore wind farm, at 66MW, at Fullabrook in Devon and we have started construction of our 38MW Mynydd y Betws Wind Farm in South Wales. We are also active in the ocean energy sector.

### **Summary of ESBI views**

We support the principle proposed in the consultation to introduce a time limited exemption to Distributed Generators (DGs) that connected pre-2005 from paying Distribution Use of System charges (DUoS). We agree that such an exemption would provide a pragmatic solution in dealing with the issues relating to pre-2005 connected DGs and the introduction of the Extra High Voltage Distribution Charging Methodology (EDCM) and would avoid the potential for complex and drawn out legal disputes. A time limited exemption, determined in advance of the EDCM coming into effect and, subject to definition, calculated from the date that DG's connected would provide the route with the greatest clarity and certainty.

Our principle objection however relates to the length of charge exemption. Many connectees paid an up front lump sum fee to Distribution Network Operators reflecting the full cost of the connection works. As such, we firmly believe that the time limited exemption should be based upon the assigned asset lives of these connection assets which were funded in full by the DG. Ofgem, in their "Decision letter on the regulatory asset lives for electricity distribution assets", dated 31<sup>st</sup> March 2011 has agreed that an asset life of 45 years is an appropriate asset life for use in price controls. It would seem inconsistent therefore for Ofgem to recommend a time limited exemption for pre-2005 DG of only 20 years in relation to DUOS charging but seek to use 45 years in relation to DNO price controls. In conclusion, and after taking these two periods into consideration, we would strongly recommend a time limited exemption of at least 30 years.

Our second issue concerns the suggestion that the connection date be interpreted as the date the connection agreement was signed. It was, and still is, commonplace for connection agreements to be signed many years before either the connection assets or the DG plant have been built. The date from which a connection agreement was signed does not accurately reflect the asset life of such a connection as the relevant distribution network assets were likely to have not been physically constructed until some years later. As a result we firmly believe that the appropriate definition of connection date that most accurately reflects the start of the connection asset life is the date the DG first exported power.

Aside from the issue of the definition of the connection date, the other implementation arrangements of introducing and determining the time limited exemption generally seem appropriate.

### **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: a time-limited exemption for pre-2005 generators" consultation.

#### **CHAPTER: One**

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

We agree with the proposal that by default EDCM generators eligible for an exemption should be exempt from charges unless that EDCM generator chooses to be subject to DUoS charges. In addition, so as to avoid instances of cherry picking, we believe that where a DG chooses to be subject to DUoS charges then this opt in should be one way and the DG would not then be able claim an exemption at a later date.

We have no comment on the position for CDCM generators.

#### **CHAPTER: Two**

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

Predictability of future charging is essential both for existing DGs and future DG investments decisions; indeed this is one of our principal concerns over the introduction of the EDCM. As a result we agree that determining the period for exemption on an ex ante basis would provide the clearest and most certain option for pre-2005 DGs.

*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?*

Whilst we agree that it would be most appropriate to calculate a time limited exemption from the date of the pre-2005 DG's connection, we are firmly of the opinion that the definition of connection date should be defined as the date at which the DG first exported power as this date best reflects the date upon which the DG started to use the distribution system and the distribution assets which it had paid for.

To define the connection date otherwise, such as the date of connection agreement or the energisation date, critically ignores the fact the actual power plant may not have been built until a much later date.

*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?*

Provided that the period of exemption is for at least thirty years and not the twenty years suggested in the consultation, then we are of the view that the most appropriate and simple option for determining the time limit of an exemption for pre-2005 DGs should be based upon "Option 3: Network Asset Lives". The contractual arrangement for pre-2005 DG's was for them to fund the full network costs associated with their connection, in some cases with a further upfront or annualised payment to cover the operation and maintenance of those assets. Therefore, it is the distribution network asset lives that should determine the period of charge exemption.

Alternatively, we could consider "Option 1: Connection agreement length" which would simply reflect the contractual position that pre-2005 DG's agreed to when signing their connection agreements with the DNOs. However, as recognised in the consultation, in the majority of cases such connection agreements have no end date and the effect of Option 1 would be an open ended exemption for pre-2005 DGs with the DNOs' other customers funding the network costs instead. As a result, we believe that a fair and transparent compromise between the two positions is a time limited exemption based on Option 3 for a period of at least thirty years.

In the case of Option 2 – the life of the generator – whether it is investment, economic or technical life should be irrelevant in determining the time limit for an exemption. We do not believe that consideration

as to the expected life of the generator, or on the type of generation technology being built, was given by the DNO when determining the connection costs payable by the pre-2005 DG's. To base the time limit for an exemption on the life of the generator may also unfairly discriminate between different generation technologies.

Finally, and although we can only comment from the perspective of our own pre-2005 connection agreements regarding "Option 4: Operations and Maintenance", we would dispute the assertion that such contracts typically included terms giving an explicit period over which O&M costs would be capitalised. Even where such terms did exist then the capitalisation periods, payment structures and payment profiles for O&M costs varied significantly across DG's connection agreements. To simply apply an "average" period of capitalisation would unfairly discriminate against the contractual position of many DGs.

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

Although we have stated our clear preferences in the previous question, the four options outlined in Chapter Two represent a realistic representation of the scenarios in which to determine the length of the time limited exemption.

We have no alternative options to suggest.

*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.*

We disagree with Ofgem's thinking that a 20 year time limit is appropriate. We are strongly of the opinion that a 30 year time limit from the date of connection would be more appropriate. Given that our preference is for the time limited exemption to be based upon the asset lives of the connections paid for by the DGs, then 20 years should be taken as merely the starting point for a time limited exemption. A more realistic time limit would be the 45 years that Ofgem has recently agreed is a more appropriate economic asset life

of for future price control. For Ofgem on one hand to have recently pressed the case for an economic life of distribution assets of 45 years for DNO price controls but then recommend an economic life of only 20 years, for the same assets but in relation to the pre- 2005 DG issue, appears inconsistent.

A 20 year exemption period could also unnecessarily advance the closure of some of the older but very flexible generation which currently provide critical balancing services to the grid, at a time of increasing intermittent and inflexible low carbon generation.

However, we are cognisant of the need to pragmatically balance the needs of the pre-2005 DGs with that of the DNO's other customers and as a result believe that a time limited exemption of at least 30 years would represent a fair compromise between the 20 and 45 year periods discussed above, the 20 year and 40+ years options in Appendix 2 as well as between the needs of the pre-2005 DGs and the DNO's other customers.

*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?*

We note that certain DGs do indeed pay an annual charge for O&M rather than a capitalised payment. In the event that such DGs are eligible for an exemption from paying DUoS charges it would appear proper that they should continue to pay an appropriate annual O&M charges, but with the important provision that any annual O&M charges are reflective and commensurate with the costs of operating and maintaining the assets they are attributed to.

### **CHAPTER: Three**

*Question 3.1: In general are our proposals for implementing the exemption arrangements considered by this consultation appropriate? Is the level of detail we have provided sufficiently clear to make implementation workable? Please outline any areas where you think more clarity/detail is required and set out your suggestions for what might fill these gaps.*

In general we agree that the proposals for implementing the time limited exemption arrangements are appropriate. Our one stipulation relates to the definition of connection date, detailed in our answers to previous questions, which we believe should be based upon the date of the DG's first power export or first use of the distribution system rather than the connection agreement date or even first energisation.

The level of detail provided in relation to the implementation also appears to be sufficient to make the implementation workable.

*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?*

Overall the approach outlined in the consultation to due process appears to be appropriate. As previously stated our main reservation relates to the determination of the connection date and an appropriate appeals process with Ofgem in the instance that the DG and DNO cannot agree upon the connection date to be used for the time limit exemption.

However, we would like to highlight that an exemptible pre-2005 DG would need to know it's indicative EDCM charges from the DNO before being able to make an informed decision as to whether they opt to be exempt from DUoS charges until a specified date, or instead be subject DUoS charges. We would also like to suggest that in the event a DG wishes to end its exemption it must provide the DNO with reasonable notice that it intends to be subject to EDCM charges from the start of the following charging year. We suggest that a notice period of two months would be sufficient. Notice, therefore, would have to be given by the 31 January that the DG intends to be subject to EDCM charges from 1 April. In addition we would suggest that unless the DG explicitly states that it wishes to no longer avail itself of the exemption and subsequently to start paying charges, then the exemption should continue to apply to that DG until it expires.

Lastly, with the EDCM regime anticipated to come into effect on the 1<sup>st</sup> April 2013 for post 2005 DGs, a resolution of the both the time limited exemption issue along with completion of the necessary due process in which to implement it, should be achieved 6 months before the 1<sup>st</sup> April 2013 in order provide

certainty and stability.

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

As Ofgem has been the main driver behind the introduction of the EDCM we believe it would be inappropriate for Ofgem to take on the role of dispute resolution between DGs and DNOs. Instead we believe that a more legitimate and equitable method of dispute resolution would be for the DNO and DG to seek independent legal arbitration.

*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?*

We agree that the simplest point from which the date the exemption is calculated would be the “connection date”, however the difficulty lies in defining what constitutes the “connection date”. We are firmly of the opinion that the point from which the exemption should be calculated should reflect the point at which the DG started to physically use the connection assets. Based on this principle we would recommend that the date from which the exemption is calculated be defined as the date of first power export, as this most accurately reflects the point at which the DG started to use the distribution assets.

As per our responses to previous questions, we cannot agree that the connection date be defined as the date the connection agreement was signed. Connection agreements by their nature are signed in advance of the either the generating plant or the connection assets being constructed, often by several years. To base any exemption from the connection agreement date would not reflect the point that the DG started to use these connection assets.

Equally, though to a lesser degree, the date of first energisation of the connection assets may also occur before the generating plant has been constructed and therefore considerably before it makes use of the distribution network assets.



*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?*

No comment.

*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?*

We agree that it would be impractical and inappropriate for DNO's to start levying charges part way through a charging year. We would also agree that it would be most sensible for the pre-2005 DG to start paying DUoS charges from the beginning of the next charging year after the exemption end date.

## **Conclusion**

Overall, we believe that the proposals contained in this consultation for a time-limited exemption for pre-2005 generators from paying use of system charges represents a welcome and practical way forward to deal with the implementation of the EDCM.

Our two main points of contention relate to period of the exemption and the definition of "connection date". From a point of principle we are of the view that any time limited exemption be based on the life of the connection assets. Given Ofgem's decision, to use an economic life of 45 years (for the forthcoming price controls) we believe that it would be logical to also base the life of connection assets on 45 years for the purposes of an exemption. We are, however, also conscious of the impact of the time limited exemption for pre-2005 DGs upon all the DNOs other customers. As a result we believe that a time limited exemption of at least 30 years for pre-2005 DGs represents an equitable and clear way forward for all parties.

In relation to the definition of the connection date from which the exemption period is calculated, our

opinion is that the definition of connection date should reflect the point at which the eligible DG started to physically use the connection assets which it paid for. We believe, therefore, that the most accurate reflection and definition of this point in time is the point of first power export from the DG. It should certainly not be date of the connection agreement which invariably pre dates the actual construction of the connection assets and the generating plant, often by several years.

In making these two points we do not wish to detract from the significant progress made by Ofgem in dealing with the introduction of EDCM charging in relation to the pre-2005 DGs. By addressing the two concerns stated above, we are firmly of the view that a practical, expedient and fair solution for all parties can be reached.

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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