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Dear Mr Donald

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

Welsh Power (WP) are the owners of Leven, an OCGT that operates under a STOR contract with National Grid (NGC) as the SO. Leven, which was built in 1991, is connected into Western Power (formerly Central Networks) and has always been a reserve provider. WP is building a biomass plant at Newport docks and has a number of other embedded generation developments that will be directly impacted by the EDCM charging methodologies.

WP has previously replied to Ofgem's consultations surrounding the introduction of the EDCM. We warmly welcome Ofgem now consulting on some pragmatic approaches to the problems that we have raised. In particular we support the exemption of pre-2005 charges from EDCM and believe that time can now be taken to adjust the methodology to make it more robust and logical.

We believe that pre-2005 generators should be exempt from paying UoS charges for the life of their asset. To cover the "missing" revenue, the balance of charges should be placed into the demand pot. Welsh Power believes that customers ultimately pay these charges, and it is more efficient to place them directly on them rather than trying, given the methodological flaws, to smear them across the remaining generator community.

Welsh Power still maintain that it cannot be cost reflective to have two methodologies. One of our plants is also on a network that has subsequently been purchased by the owners of another network that use a different methodology. We are concerned that the prospect of changes in methodology makes the instability, lack of predictability and transparency even worse. We agree with others that the charges send signals we cannot see and cannot respond to and we therefore support a longer term examination of the way the charging regime works.

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?

Removal of the pre-2005 generators better reflects the costs of DNO's systems of those generators who had already paid up front for connections. However, we are not convinced that simply shifting the residual revenue requirement onto remaining generators is cost reflective and importantly does not overcome the broader problems that we see with the methodology.

Ofgem's consultation provides data on the changes in revenue received from post-2005 generators, but that does not tell us if there are specific sites that suddenly pick-up a 20% increase in prices. We know from our own plant that some generators carry what appears to be a disproportionate level of charges by virtue of being based in a "congested" part of the network, despite having no control, or understanding of, the network configuration and sites that have sited nearby some years after our plant was built. Without seeing the site specific charges WP cannot say that the impact is equitable or not, but we suspect it is not.

As well as having potentially disproportionate impacts on some generators, the volatility in charging will also remain. A small percentage change on a large number can, particularly for the smaller plant, be extremely damaging to their business. As we have previously noted, these are not risks that generators can hedge against.

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?

WP has always maintained that the generator led reinforcement charge is unfair, as the generators have no control over their location after they connect. The charge can be highly volatile as a result of the behaviour of other parties. The charge can also create some perverse signals, for example if we increase the capacity at our site in a "congested area" we would reduce the charges for both our existing plant and any new plant we built. We agree that sending signals about where to locate new generation could improve the efficiency of the development of the network as a whole, but that is not what the locational charge does.

While removing the charge would address some of the problems that we have identified with the methodology, it does leave the issue that the fixed charge would be very high for plants that may use the system very rarely, such as STOR plant. Such plant are invariably operating to support the system as a whole so should face see some benefit from this behaviour reflected in the charges. We would therefore like to see further consideration given to the methodology as a whole rather than making a "patch" to the existing methodology as a way to fudge the issues.

We believe a more fundamental review of the way plant such as STOR is charged and treated by the methodologies is needed. We have heard the argument that STOR plant running does not necessarily support the local network, but as our STOR plant was built by the local network owner (at the time when DNO's owned generation) our DNO has agreed, in informal meetings, that the plant was specifically designed for and fulfils that purpose.

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?

In general we support monopoly charges being stable as there is no way that these charges can be hedged and their volatility therefore creates an unmanageable business risk. We disagree with Ofgem's assessment of the "locational" signals that remain under this option as well. The connection charges and sole use asset charges are to do with the design of the plant as much as the location. Locational credits are linked to operations which some plant has little or no control over. As the charges are also not fixed (as they were for the pre-2005 generators) there is an inherent risk that the charges when you connect will not reflect the charges when you energise let alone those arising in ten years time.

WP would rather see Ofgem and the DNOs work to create a more robust methodology where the charges are more stable and transparent, creating a charging regime that encourages investment.

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?

Of the options Ofgem as proposed WP believes that this is the most sensible, though it would not address our concerns with the underlying methodology. By leaving the non-exempt DG charges unchanged (compared to the other options) and allowing exempt generators to re-enter the charging pool without impacting all other DG has significant advantages.

We note Ofgem's assertion that the impact on customers would be minimal, but cannot see any analysis that backs this up. WP has always maintained that the customers will ultimately carry the costs associated with generation (where on balance they can be passed through). While this may not be the case for individual companies or sites, customers generally pay for generation costs in total. It is therefore probably more economically efficient to levy charges directly on the customers.

Again we note that, like the other options, this does not address the fundamental problems with the methodology. Ofgem would also need to check that there are no disproportionate impacts on specific customers' sites.

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?

WP believes that in principle the EDCM generators should recover their share of the DNO's revenue, but the incentive revenue of £1/kW has always seemed rather arbitrary and non-cost reflective. We feel that limiting the collection from generators to the actual costs that their connection incurs rather than something that includes the £1/kW incentive payment is a marginal improvement to the methodology. However there remain wider concerns with the methodology, such as scaling factors that are used to hit the revenue target.

The £1/kW price control allowance is meant as an incentive to connect generation rather than a direct recovery of costs actually incurred and as we have pointed out previously it is in fact a signal that the generators cannot see and cannot respond to. Therefore recovering this revenue from demand (who of course will have to pay it ultimately) would seem a more efficient solution.

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

WP would like to see the methodology revised more widely. Ofgem's general intention in suggesting the revision to the methodologies set out some reasonable goals for designing a new methodology. However, despite the number of consultations that have occurred, we have had a general feeling that the comments of the market participants have been dismissed until this consultation. In particular we still believe a "common methodology" can only be common if there is a single methodology and not two.

More broadly, EDCM does not meet the principles that we believe should be applied to monopoly charges:

- They should be transparent and capable of being understood and ideally forecast by the parties paying them;
- They should be predictable and stable;
- They should not create signals that parties cannot respond to; and
- They should not put the businesses liable for the charges at risk of failure.

We would like to see the DNOs look at how they can create a more robust, less volatile set of charges that allow new sites to respond to locational signals and charge existing sites on the basis of some cost reflectively, but with far more consistency and transparency than is currently the case.

At the very least the methodologies should not levy more than a certain proportion of charges on a specific generator. It cannot be the case that a single site is accounting for say 20%-30% of all the DNO's generation related costs. Ofgem has already suggested that the DNOs develop some new products to try and offer parties the opportunity to be rewarded for actions that support their networks. This type of product needs to be reviewed with the super red time bands, the boundary definitions, etc...

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

Generators can respond to signals that tell them transparently that the connection charges and then UoS charges will be lower if they site new plant in a given area. We would like to see some map of each DNO flagging zones of spare space. At the present time the process of asking for a connection, waiting for an offer and then discovering the plant would be uneconomic in that region takes far too long.

Once connected some plant, but not all, can alter their operations to take advantage of time related tariffs or respond to direct instruction in return for financial rewards. The amount of response will depend on the plant type and its design against the market in which it operates, i.e. STOR plant cannot respond to the signals as it is contracted to NGC, nor can wind as its operations are weather driven. That does not mean that these plants do not necessarily produce

benefits, but there is a need to ensure that they are rewarded when they are providing support and are not forced into trying to meet and operating regime that is not consistent with their business.

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

Where plant is supporting plant, rather than base-loading, it should have charges that are based more on the use of the system and not on the capacity of the plant. DNOs should look at these plants and see what support or costs they are actually imposing on the systems. Where such plant could guarantee not to use the system at certain times, for example middle of the night in the summer, they should still be able to get a discount from their charges. Ofgem is keen to encourage demand-side management and this would be equally applicable for generators who provide system support services.

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?

Option 3 is we believe the best proposal, but we would still prefer to see the methodology as a whole reviewed.

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

See above.

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

Aligning charges changes with the charging year is always the best way to introduce changes as it allows for the DNOs customers, generators and suppliers, to factor those charges into their own businesses. We believe it will take until at least April 2013 to agree changes to the methodologies, for the DNOs to agree who the exempt plant are and to then issue indicative charges to all of their customers. If these changes are approved, as well as altering their charging bases, the DNOs still need to give enough time to publish indicative charges.

If Ofgem decided that wider changes are needed it would have to reconsider the implementation time frame. We appreciate that Ofgem would like to get the changes implemented as soon as possible, but still believe that the methodologies are so fundamentally flawed that changes would allow the original objectives of the common methodology to be far better met.

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?

WP believes that the boundary changes implemented by Ofgem are not robust and should also be reviewed. We have previously set out our views on this in 2010.

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

No.

Yours sincerely



Alex Lambie
Chief Executive