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Dear Guy,

Subject: Consultations on *Distribution Use of System Charging: A Time-Limited Exemption for pre-2005 Generators* and *The Way Forward on Higher Voltage Generation Charging*

We apologise for the delay in answering, and we understand that the consultation is now closed but we would be grateful if you would take our response in to consideration.

Vattenfall owns 431MW of installed wind capacity in the UK with a further 150MW in commissioning, a pipeline of onshore projects across the UK to be connected to the distribution network, and a joint venture with Scottish Power Renewables to develop the Round 3 Zone 5 located off East Anglia with a potential of up to 7.2GW of offshore wind.

We welcome the opportunity to offer comments. This response contains our views on both of Ofgem's linked consultation documents: *A Time-Limited Exemption for pre-2005 Generators*; and *The Way Forward on Higher Voltage Generation Charging*.

We have provided greater detail on the first of these consultations concerning pre-2005 charging to distributed generation (DG); the proposals have a direct impact on Vattenfall's assets at Kentish Flats, and we have consistently opposed Ofgem's proposed interventions in this area. It is also relevant that the second consultation, in our view, simply increases the complexity of a process requires significant further development work.

A Time-Limited Exemption for pre-2005 Generators

We remain of the view that all pre-2005 DG should not face use of system (UoS) charges, and we do not agree with Ofgem's position that introducing UoS charges to DG connected prior to the introduction of new charging arrangements in 2005 would result in all DGs being treated the same or fairly. Introducing regulation retrospectively also confirms policy risk that ultimately increases costs to account for the extra risk to be hedged. These are ultimately passed through to suppliers and through them to consumers.

Ofgem's position also goes against wider policy evolution principles, where conditions prevailing at the time investment is made are usually "grandfathered". In this context plant connected before 2005 cannot respond to the new price signals and investments in such plant were made based on parameters known at the time.

That said we believe the thrust of the latest Ofgem proposals improve on the previous position communicated in May and based on the compensation route. There remains the need to refine the current proposals, as these:

- have not been sufficiently analysed. There is no impact assessment on the materiality of Ofgem's concerns, nor the benefit in pursuing its preferred option;
- are unlikely to be workable in all cases and could lead to lengthy dispute resolution procedures, which until resolved would result in uncertainty for all network users; and
- for the reasons set out above are unfair to pre-2005 DG.

To ensure simplicity any time-limited exemption should be established from the point at which the DG was connected (or energised where this is not known) and then last for 30 years—this being the length of the average connection agreement (and near the average economic life of DG plant) presented by Ofgem in its consultation.

The Way forward on Higher Voltage Generation Charging

With regard to the *Way forward on Higher Voltage Generation Charging* consultation, which sets out proposed changes to the EDCM for generation charging to reflect the impacts of removing exempt generators from the charging methodology, Ofgem should adopt the simplest and least disruptive solution.

Of the five options put forward for consideration, the easiest to implement and understand is the first. This is to apply the EDCM as proposed by DNOs, meaning that exempt generators would be excluded in both the calculation of the generation revenue target and the scaling of charges to that target. Although this could see an increase in charges for some generators, we are not convinced that the potential for increased charging volatility would be any more material than under the introduction of the EDCM itself. We recognise individual generators may be impacted differently, but this is not possible to ascertain.

The remaining options would introduce greater complexity, resulting in future charges being less predictable than they already would be.

Given the level of concern raised by respondents to the EDCM proposals, as acknowledged by Ofgem in the two consultations, it is disappointing that the opportunity was not taken to address more of these concerns, rather than focus solely on the need to attempt to introduce cost-reflectivity principles to pre-2005 DG charges. As is usual with consultations on these subjects, evaluation of the options is greatly hampered by the absence of any indicative estimates that might allow us to quantify possible impacts.

Below are our more detailed answers to the consultations questions in the *Pre-2005 Generators* document.

Please let me know if I can provide anything further.



Willem van Dongen

Head of Operations UK

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 to be exempt from charges, unless either party chooses otherwise?

EDCM generators should continue to be exempt from charges, at least as an option. As highlighted in the consultation contractual issues give rise to complex considerations for individual sites that makes a common resolution difficult to implement. DG should be subject to similar rules irrespective of the level of connection.

We would also reiterate that we do not agree with Ofgem's rationale that introducing UoS charges on a common basis for all generators (i.e. those connected prior to April 2005 and those subsequently commissioned) results in generators being treated on the same basis. This is because DG connected prior to the change in charging methodologies would have appraised their investments on the expected costs of the time, which obviously and materially differ following the implementation of the 2005 Distribution Price Control Review (DPCR4).

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

An ex ante approach to setting a time-limited exemption is more appropriate than trying to introduce ex post arrangements for the reasons given, with one caveat—that, once the exemption time-limit has been agreed, this cannot be changed at some point in the future.

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?

Yes, the simplest approach to a time-limited exemption would be to calculate it from the date of connection. This would result in end dates for the exemptions being known (as would calculating the date from a fixed point for all DG, such as the commencement of the EDCM for DG). Provided that any exemption is based on an ex ante appraisal, this approach would minimise tariff disturbance in future years.

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?

While we feel the scope of options is complete, the analysis of options for determining the time limit for exemptions is lacking.

The average connection agreement is presented as 30 years (with a range of 19 to 40 years); analysis of DG plant lives results in 22 years (investment life) or 32 years (economic life); economic network asset lives are currently 20 years (although this will rise to 45 years for the next price control reset due in 2015); and the technical life of the network asset is stated as between 60 and 75 years.

There is no consideration given to the use of a network asset (or its value) following the closure of a DG plant. For example, if the original investment was made on the basis that the connection agreement would cover all connection and operation and maintenance (O&M) costs for the length of the average connection agreement or economic life of the DG plant (30 to 32 years), then the connection asset could potentially have between 30 and 45 years of technical life remaining. The expectation at the point of commissioning was that connection charges would cover asset maintenance costs, therefore levying UoS charge on pre-2005 DG will see them pay twice for that maintenance and put them at a competitive disad-

vantage compared to post-2005 DGs and any subsequent investment in new generation that utilised the existing assets (which could last for the life of the second DG plant using the connection assets).

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

As noted in the response to Question 2.3, the range of options is probably sufficient, but more analysis is needed.

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.

A time-limited exemption should be linked to the length of the average connection agreement (30 years) and the economic life of DG plant (32 years).

Further more the case has not been made that a 20 year exemption would:

- ensure that all DGs are exposed to the same UoS charging signals in a reasonably timely manner. Putting aside the validity of exposing all DG to the same charging signals, 20 years does not appear “timely” and is arbitrary;
- facilitate more efficient use of the networks. Additional costs placed on DG that cannot respond to pricing signals will simply be passed through to customers with no change in behaviour from the plant. Where costs cannot be passed through, output of (generally low-carbon) plant could be curtailed; and
- be in the interests of all users. No evidence is presented by Ofgem that pre-2005 DG connections were made on the basis that they would face no UoS charges for life, as the expectation should be that O&M costs were negotiated to cover connection the upkeep of connection assets. DG brings wider network benefits by offsetting the need to invest to meet the needs of demand 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?

Yes.

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.

Given the change in position from Ofgem since its May 2011 consultation, the current refund arrangement proposals are probably appropriate.

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?

The due process approach must have clearly defined timeframes, particularly response time from DNOs. DNOs must officially acknowledge, in good time, receipt of all communications from affected DG. The timing of the process must have regard to the UoS charging year so

that any changes a DG has to absorb can be done so in a reasonable time (no less than six months). It must also have regard to legal review timeframes.

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

Yes. DGs should face no additional charges during the resolution of a dispute.

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?

Where the connection date is known this should be used, with the energisation date only used where the connection date is unknown.

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.

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—provided that the new charging year is more than six months away.

