Welsh Power Group Limited
Ground Floor, Tuscan House
5 Beck Court
Cardiff Gate Business Park
Cardiff CF23 8RP
Tel: +44 (0)2920 547200
Fax: +44 (0)2920 549896
info@welshpower.com

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Mr Guy Donald
Distribution Policy
Ofgem
9 Millbank
London
SW1P 3GE

To: distributionpolicy@ofgem.gov.uk
cc: rachel.fletcher@ofgem.gov.uk
guy.donald@ofgem.gov.uk

Dear Mr Donald

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

Welsh Power (WP) are the owners of Leven, an OCGT that operates under STOR contracts 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 and have always maintained our belief that the pre-2005 generators should be excluded from any DUoS charges in line with the terms under which they connected. In responses to consultations on the changes to the methodologies WP has raised a wide variety of issues and we welcome Ofgem's attempts to try and address some of these issues.

We believe that pre-2005 generators should be exempt from paying UoS charges for the life of their asset. If Ofgem insists on having a fixed number of years, WP believe a number near 35-40 years aligns with our expectations of the asset life associated with the plant on both our site and the DNO's network.

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.

WP believes that all pre-2005 generators should be exempt from charges as they paid for deep reinforcements, along with connection assets, at the time they connected. We have always disputed Ofgem's assertions that these charges did not confer on the generators the right to use the distribution system and it is still our view that the connections were both a purchase of the assets that the DNO required to make a connection as well as giving the generator the right to then use those assets in line with their connection agreements.

We agree with Ofgem that the time limited exemptions route would be significantly less complex and costly to administer than some form of refund system. There is a lot to be said, with the level of wider market changes at the present time, for adopting the simplest solution to the problem, creating certainty and transparency over future arrangements. This will then allow generators to get on with their businesses.

WP does not understand why the CDCM generators of a similar age should be treated differently, but we recognised that they will generally be smaller plant and, by virtue of the methodology, will be paid rather than to pay UoS charges. We therefore agree with Ofgem's proposed approach to the CDCM generators as a pragmatic solution.

We also agree that there should be a one off chance for generators to decide to be charged under EDCM/CDCM. This choice should be a one way option, so once a generator has moved to be under EDCM they should not be able to switch back.

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

Yes.

WP agrees with Ofgem that the additional certainty from a set ex-ante date would allow plant owners to then plan for the asset's 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?

WP believes that the energisation date would be easier to define than the "connection date". Many connection agreements were signed based on an expected connection date, but both the plant and the DNO may not have had their assets ready for the connection date specifically set out in the construction agreement. Where plant has changed hands, agreements been altered, etc. there may be no evidence as to what the original "connection" date was. There is, in our view, more likely to be evidence of when a plant was energised as there are likely to be metering records, O&M contract start dates, etc…

Energisation also fits with the date that the generators actually started to use the assets that the DNO had put in place for it. It is important that the generators were actually using the assets, as it is usually use of an asset that prompts payment for it, where before that point the generator is securitising the assets rather than paying UoS charges. This would make the period of exemption align better with when assets would be used, not when they intended to be used.

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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?

WP believes that when plants were built there was a reasonable expectation that they would operate for an average asset life. They asset owners may have different asset life expectations for different generators, based on the way that the plant operates, its technology type, etc… However, we recognised that to create asset specific exemptions would be costly in terms of time of effort. This means that Ofgem must strike a balance between protecting the owners rights to enjoy their property and creating an "average" asset life against which to set an exemption.

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

No.

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.

No.

WP does not believe that 20 years is in appropriate time as it is not reflective of the asset life of most plants. As noted above, WP believes it was reasonable of the asset builder in the case of Leven, who financed the connection, to have expected a reserve plant, operating only limited hours in a year, to go on operating between 35-40 years. When WP purchased Leven we to assessed that the economic life of the asset would be in the same range, given its condition, operating regime, etc…

30 years is a far shorter asset life than would be used either by a generator or by the DNO, as recognised by Ofgem in stating that the asset lives in their price controls are not the same as economic lives they propose to set at 45 years from 2015. It would therefore be far more reasonable to base the exemption on the asset life, either the DNOs or the generator.

WP has no say over how the DNOs use their assets, when they replace them, or over events that may trigger replacements or upgrades, such as new connections. WP does have reasonable expectations about the life of its own asset and we can control the frequency of maintenance, operating regime, etc. that may be used to extend asset life. As we could not judge if the DNO has reasonably undertaken asset replacement, let alone understand how that asset replacement related to our plant. However, the DNO will be aware when a plant stops generating, so using the generator's asset life is simpler and easier to administer.

WP therefore believes that the exemptions should run for the generator's asset life. We would define this as being the time when the plant either closes or is subject to a replant. We believe that the DNO would know of plant closures, or replanting, so it should be relatively easy for the DNO to keep a list of such plant and to notify Ofgem when their time without UoS has come to an end.

WP believes that a replant, or other form of asset replacement, is likely to lead to an alteration of the connection requirements as a minimum. This is because technological changes in generation equipment mean that they often require slightly different connections than the older plant. We therefore do not believe it would be realistic for a generator to replace older equipment without the DNO having to make at least some changes to the connection and therefore be aware that the generation asset has altered.

If it is the case that the DNO has replaced equipment associated with the generation asset earlier than the plant closure, we would assume that this is done in an economic manner. We believe that, given the level of investment required in the DNO networks there are already a lot of deeper reinforcements going on simply as a matter of ongoing maintenance and system expansion as the changing role of the DNOs networks evolve. To therefore link the UoS exemption to the asset life of the DNO would be difficult to monitor and the generator would have no way to know if the claimed replacement of assets associated with a specific plant really is used for that plant.

WP does not agree with Ofgem's assertion that the customers are paying for charges that the generators would otherwise be subject to and therefore the exemption should be limited to 20 years. WP, like other generators, paid upfront for the connection costs, including O&M and other associated distribution related charges. How the DNOs calculated the connections costs at the time we agree is unclear, but if they failed to charge as they were meant to, i.e. covering the full connection costs, it is the DNOs who may have over or under charged rather than the generators who have over or under paid.

WP also questions which "signals" provided by the UoS charging Leven is meant to be responding to. We cannot move the generator to another area, we cannot run it in the "super red" time bands due to the nature of the STOR contracts, so we are confused as to what value the "signals" will deliver to plant such as ours. We understand that a new generator may use the charges as a locational signal, but as we have highlighted previously, often locating a generator in an already constrained or busy area can actually trigger reinforcement that will reduce UoS costs under EDCM.

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.

WP feels that the O&M charge is being levied that will be for a service, on top of the connection, that the asset is receiving from the DNO. We see no good reason why the generator would not go on paying these charges going forward.

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.

Yes.

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?

WP believes that if arbitration is required disputes can be taken to the Electricity Arbitration service.

The process itself looks relatively straight forward so it should take little more than a couple of months to implement. That said there are a number of generators who may not have all of the required evidence of connection and/or energisation dates at their disposal, and we know that some DNOs can be very bad at knowing how to actually contact their customers. Realistically we therefore believe that it is likely to take in the region of 6 months to make sure that all generators have been contacted, disputes resolved and reasonable closure dates established.

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.

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?

WP believes that the energisation date is a better date to use than the connection date. We believe that "connection dates" as specified in construction contracts (where they exist) where often not the date that was met by either party for a whole host of reasons. The date may have been earlier or later, but the point of energisation is when the generator started to use the assets and seems a more robust point in time than the "connection date" against which to judge the period of time that the assets were used for.

WP also expects that the energisation date will be easier to establish and less likely to be open for debate or interpretation.

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.

These sites are likely to be in the same position in terms of having pre-paid for their connection assets.

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.

However, in order to ensure that the DNO can give the correct figures for all charges to customers, it would have to have known at least 6 months prior to the start of the charging year which generators were going to be in and which out of its charging base. It must therefore notify the generator that it expects to start charging it from the next year with enough time to allow for any disputes to be raised (however, unlikely).

The same applies to the voluntary paying of UoS charges. If a generators wants to pay in 2013 it must have told the host DNO by September 2012 to ensure that the indicative charges that the DNO gives to all other parties are correct.

Welsh Power hopes that this response is of help, but if there are any points that you or your colleagues would like to discuss further please contact Lisa Waters on 020 8286 8677.

Yours sincerely

Alex Lambie
Chief Executive