

## **Review of arrangements for distributed generation Working group Terms of Reference**

### **Purpose**

1. The DG Review Report and Energy White Paper published on 23 May 2007 gave a commitment for DTI and Ofgem to consult later this year on options for more flexible market and licensing arrangements for distributed low-carbon electricity within the licensed framework, to be implemented by the end of 2008. This Working Group will develop the options for consultation.
2. The overall objective is to develop measures that address the key barriers within the market or licensing arrangements to the greater take up of Distributed Generation projects. We will seek to identify workable solutions that minimise the barriers to entry for DG.

These solutions will:

- Seek to simplify the system for potential generators and suppliers
- Ensure that DG receives appropriate rewards for the benefits that it provides; and
- Ensure that consumers are adequately protected.

They will not:

- compromise the integrity of the competitive market; or
- impose unnecessary costs or complexity on DG generators, or those parties that seek to purchase from them;

### **Terms of reference**

3. The workgroup will explore the commercial, environmental and regulatory issues that arise in the context of small, low carbon generation (both in the case where it does and does not supply on-site demand). The work will seek to understand to what extent there are factors in the market or due to regulation that unduly obstruct the ability of these projects to be sustainable, commercial business propositions.
4. There will be 3 core components to this work, building on the findings of the DG Review. The Group will
  - i. establish what drives the differential between the export tariff for DG and the import tariff, identifying:
    - o where this represents the underlying cost of electricity supply; and
    - o where there is evidence of underlying market or system failure and what measures could address this
  - ii. identify the cost drivers that underpin the value of distributed generation to licensed suppliers and look at solutions that might reduce these costs.
  - iii. look at the full range of solutions that have been identified and assess how these improve the value received by DG projects. At this stage the group will explore whether there is an incentive for DG to supply direct to local consumers rather than exporting to a licensed supplier and devise additional measures as appropriate

Regard will be given to a range of DG projects with different scale and profile of export.

5. The work may also involve looking at the effects of the industry cash out arrangements on DG. If the current cash out is not cost reflective, this may lead to electricity from DG projects not getting the value it might otherwise secure. However, to the extent the value reflects merely the unpredictability or volatility of DG sourced electricity, there may not be a case for change.
6. The Group will be asked to comment on the core model for understanding the export and import offers and to assist where possible in populating this model with representative costs.
7. The Group will evaluate the options and identify likely implementation issues, including potential costs. It will also consider potential opportunities for developing arrangements on a trial basis with a small number of parties to learn by doing.

### **Output**

8. The Group will assist Ofgem and DTI to produce a preferred package of measures that addresses the specific issues identified and a proposal for consultation, including implementation steps.
9. The package of measures is not expected to result in a new class of licence as the activities being considered are already defined as licensable activities under the Electricity Act 1989.

### **Context**

10. The work of the Group will build on the findings of the Distributed Generation Review. The report of the Review can be found at [www.dti.gov.uk/energy/whitepaper](http://www.dti.gov.uk/energy/whitepaper)
11. The Group should have regard to other related areas of Ofgem activity including:
  - Review of cash-out arrangements
  - Supply Licence Review
  - Microgeneration Forum
  - Export reward for microgeneration
  - Electricity distribution structure of charges project.

### **Principles**

12. The Group will
  - provide a forum for discussion but will not have formal decision making powers and will not preclude full consultation on the issues.
  - conduct itself in an open and transparent manner.
13. Working Group members will be expected to:
  - Provide expert advice based on their experience and knowledge; and
  - Provide a conduit for the views of the industry sector to which they are affiliated.
14. Working Group members will be encouraged
  - to submit papers as required, highlighting issues and identifying potential solutions.
  - to share experience with developing DG schemes including bringing forward specific details of these schemes, whilst respecting commercial sensitivities.

### **Membership**

15. The Group will be chaired by Ofgem, supported by DTI, and will be made up of volunteers drawn from a cross-section of industry sectors.
16. Further specialists may be invited to attend certain meetings as deemed necessary and agreed by the group and Ofgem.

### **Administration**

17. Ofgem will produce a summary of key issues from each meeting. The agenda, meeting notes and associated papers will be published on the Ofgem website.
18. Members are not under any confidentiality requirement and will be encouraged to report back to other parties on the issues that have been discussed.

### **Timing**

19. The first workgroup meeting will be on 30 May 2007 where the key areas of work and the underlying questions in each area will be agreed. The group will meet until the Autumn when there will be a wrap up meeting to agree on the package of measures for consultation and to discuss implementation matters.

### **Background**

20. The Energy White Paper announced that DTI and Ofgem will consult by end 2007 on options for the creation of more flexible market and licensing arrangements for distribution connected, low carbon electricity.
21. Prior to the Energy White Paper, DTI and Ofgem undertook a review of the incentives and barriers that impact on distributed generation and a Call for Evidence was published in November 2006. The consultation responses identified a number of barriers including issues around export reward and the regulatory framework. In particular, the complexities and costs facing small generators seeking to supply localised demand were identified as a specific barrier.
22. A number of models have been identified that provide for a licence exempt generator to supply a local customer located at a different site. The unlicensed generator can:
  - A. Contract with a licensed supplier:
    - for the entire output at the generation site; or
    - for top-up, standby and export where the licence exempt generator has own demand either on-site or elsewhere locally;
  - B. Become a licensed supplier; or
  - C. Construct a private network.
23. Many consultation responses argued that suppliers are not paying a fair price for export, and that the difference between the export and import price means that Option A above is unattractive. This has driven respondents to consider either becoming a licensed supplier, or to set up a private network in order to capture greater revenue for their generation.
24. However both of these routes place a significant additional burden on those seeking to become distribution connected generators. Being a supplier and participating in the wider market means exposure to imbalance and customer switching risks that are difficult and costly to manage for small schemes. Similarly, owning and operating a network of cables into homes and businesses requires a significant degree of expertise to achieve safely and

efficiently and therefore itself presents a barrier to entry for Distributed Generation. It is further the case that private networks usually tie customers into long term contracts thereby removing the customer choice and protection that is provided through the competitive retail market.

25. Against this backdrop it is clear that we need to explore the market and regulatory arrangements to arrive at a package of measures that will allow small generators to obtain a proportionate reward for their output in a way that does not in itself create barriers to entry to DG, or reduce consumer protection.
26. In parallel with this workstream Ofgem will be conducting a review to ensure that the market for residential scale exported electricity is working effectively and to identify whether microgenerators are being fairly rewarded. The working group will have access to any relevant information from this review as it becomes available.