Distributed Energy (DE) Working Group, Ofgem, 05 July 2007

Attendees

Name	Organisation	Name	Organisation
Philip Davies	Ofgem (Chair)	Malcolm Taylor	AEP
Rachel Fletcher	Ofgem	Alan Jones	London Climate Change Agency
John Kemp	Ofgem	Terry Ballard	nPower
Nick Rubin	Ofgem	Nigel Cornwall	Cornwall Consulting
Vanja Munerati	Ofgem	Roger Barnard	EDF
Ijaz Rasool	Ofgem	Mike Smith	Utilicom
Cherie Davis	Ofgem	Tony Thornton	Centrica
Martin Crouch	Ofgem	Chris Welby	Good Energy
Stephen DeSouza	BERR	Katherine Marshall	SSE
Rita Wadey	BERR	Dave Miller	CE Electric
Dave Sowden	Micropower Council	Ralph Chamberlain	E.ON Central Networks
Robert Tudway	LCCA	Derek Scally	EDF

- The purpose of the Group is to investigate and propose options for removing barriers in the market and licensing arrangements to the development of Distributed Energy. The aim of this second meeting was to explore the various settings in which DE schemes are deployed and develop understanding of the specific issues surrounding DE as set out in the Ofgem discussion paper circulated prior to the meeting.

Summary of discussion

- Philip Davies introduced the Group to its second meeting. He summarised the last meetings discussion and re-iterated that Ofgem's work in relation to DE would be guided by its principal role to protect the interests of customers. He also said that whilst Ofgem would remain flexible when considering solutions it had a recognised preference toward solutions that could be developed within the existing licence framework.

- It was noted that since the last meeting Ofgem had met with many market participants to discuss their particular views in relation to DE. However, whilst these meetings had been useful, Ofgem is reliant on the group for detailed examples of DE in operation, and he encouraged participants to come forward with this information.

Comments on the minutes

- The minutes were approved subject to a couple of comments:
  - An action from the last meeting in relation to circulating the code of practice developed by the CHPA remained outstanding; and
  - One member of the Group suggested clarifying the minutes to note that import pricing as well as export pricing arrangements are important for DE.

General discussion

- The group made the following opening remarks.

Licence framework/Trading arrangements

- The group revisited the issues surrounding the existing licencing framework - whether it is possible for DE to work within the framework or whether DE requires special arrangements. The following points were made:

    - BERR noted that raising exemption limits is ruled out unless this is the only way forward. However, there may be a case for clarifying the exemption regime;

    - A number of participants suggested that the framework might prove flexible enough to be adapted to DE needs. iGTs and iDNOs, which have alternative licensing arrangements to the gas DNs and electricity DNOs, were used as an example.

    - It was noted that many industry players have difficulty dealing with the complexity of the current market arrangements (eg the need to be a party to BSC and CUSC), find it difficult to change industry rules to make them more suitable to their own interests and find it difficult finding a route to market. Unless these matters are addressed – for example through arrangements where existing licensees could discharge license obligations on behalf of DE participants - there will continue to be pressure from DE for special license arrangements.

    - Some participants noted that DE is different – not because of the technology it uses but because a) it has a different function from traditional energy market participants and b) it was often heat led.

    - Customer protection was recognised as a key issue if we were to develop special ESCO licenses. It was suggested that such protection could be incorporated into any specific changes to the licensing regime that may be required to facilitate DE.

    - The group was reminded that exemptions can have conditions attached to them. Later this point was repeated with the reminder that a price cap can be placed on exempt suppliers.

    - Ofgem pointed out that the market trading arrangements described in the industry codes were designed to be flexible, technology neutral and incorporate consumer protection, which is considered to be an important component of these arrangements. Ofgem further reminded the group that industry participants could propose changes to these arrangements if they were deemed necessary to address barriers to the take up of DE.

- Ofgem stressed that the group still needs to agree what the issues are that prevent greater take up of DE schemes before addressing possible solutions.

Working Group timeframe

- Some concerns were expressed in relation to whether the timetable presented was appropriate given developments in London that will require licensing arrangements from the middle of next year.

Discussion of paper 2: Nature of Distributed Energy

- Ofgem presented a number of slides to introduce the key points in the discussion paper. The following key points were made under each area.

Fairness of export rewards

- The Group considered what ‘fair’ export reward meant.

- In general, participants thought that the term ‘fair’ was misleading. The remark was made to the fact that what was ‘fair’ value for a generator might not be ‘fair’ to a supplier. It was also noted that a ‘fair’ export price was difficult to determine as it depended on what the customer required, i.e. some require a fixed price contract, top up service, balancing etc. It was also noted that different suppliers are exposed differently to the risk of imbalance and non-delivery than others. It was also noted that the embedded benefits of DE change over time and that it would be difficult to make a blanket statement about what is a fair value for DE.

- The Group considered that the level of risk associated to DE export was a primary driver for export reward offers. This risk was mainly as result of the low volumes of energy being exported and the low level of reliability associated with that energy.

- It was agreed that it was not viable to look for subsidies for DE schemes but to ensure the market did not penalise DE exports.

- One member of the Group said that the price was determined by the level of competition in offering export and export reward. There was some discussion in relation to the competitiveness of the market and whether there were adequate routes to market for DE.

- The group discussed the NFPA auctions process and it was noted that the last auction resulted in price of £72/MWh. The group noted that this should be treated with caution as not all DE schemes are eligible for ROCs/LECs and that significant balancing cost might be incurred in case the power was not delivered - although it was noted that risk is reflected in the price.

- Ofgem noted that the NFPA or similar auctions that enhanced transparency and competition could be an effective way of bringing buyers and sellers together. One member of the group noted that the NFPA has looked to extend the market but that generators had not shown much interest.

- It was noted that in order to derive a fair value for export, one needed to effectively price carbon. Ofgem noted that the second phase of the EU ETS was commencing in 2008 and that the participants should benefit from an electricity price that reflects the effects of EUETS coming through with carbon accounting for about £8/MWh in forward electricity prices.

- The Group considered why there was a difference between the import and export price. One group member suggested that the chart in Ofgem’s first discussion paper was a good illustration of how prices are derived and it was for other group members to provide further explanations. Other members of the group considered that Ofgem could do more to better understand the drivers and risks behind the different prices offered by suppliers,

- It was suggested that the current cashout mechanisms are an important driver of the price suppliers are willing to pay for export. The current arrangements may unduly penalise parties who are inflexible, spill energy or where power generation is a secondary consideration, and cashout arrangements can offset any DE benefits.

One participant noted that the lack of attractive export reward is the key incentive for private wire networks. One group member enquired whether there were alternative ways of managing risk from the model that was used in Woking. Another member of the Group said that it was not possible.

Incentives for constructing Private wire (PW) networks

- It was suggested a private wires network would allow DE schemes to capture the full retail price but avoid a large number of charges a licensed supplier would incur.

- Some members of the group were not convinced that a private network could compete with the economies of scale a public network was able to derive. It also remained unclear whether a private network was actually avoiding all costs (as opposed to charges) associated with a public network, eg meter reading, network maintenance/reinforcement etc, or that the costs being incurred were necessarily more efficient.

- It was also noted that the economics of DE is different from stand alone electricity schemes, because these schemes increasingly offer a range of services (water, cooling, heat as well as electricity), and some suggestion that this may explain how private wires add value to DE schemes.

- The group noted that it was counter intuitive that DE could develop only within PW/licence exempt model. Comparison was made with iDNOs/DNO and the group considered whether there was an issue if there was an incentive to invest in PW.

- It was noted that any solution put in place to encourage the take up of DE needed to be scaleable. It was also suggested that if de-carbonisation is the governments aim then it may need to consider changes to the exemptions regime to allow quasi franchise arrangements which give a local monopoly to DE schemes.

- It was noted that the distribution use of system charging arrangements on public wires was not a factor in deciding to create the Woking scheme but that the key driver was the gap between import and export prices.

Suppliers' risks

- The group discussed various ways of securing finance and options such as franchise arrangements were considered.

- Some members of the group said that securing adequate financing for DE projects was a considerable barrier to entry. It was considered that PW networks therefore provided an assurance of revenue flow that was more likely to attract investors.

- Some group members suggested that not all DE and PW schemes were seeking to lock customers in to long term contracts, noting that a number of schemes are competitive against the major suppliers. The point was made that it may be possible to create arrangements that allow customers to switch between DE suppliers, thereby allowing some customer choice over supplier.

Exempt supply services

- It was recognised that exempt supply services could allow non-licensed suppliers the top-up, export and stand-by services they need and that in theory, this type of arrangement could be extended to small licensed suppliers to alleviate the burden associated with complying with industry codes etc.

- However, it was noted that there is very little evidence of licensed suppliers offering top-up and standby services, except in the case of the Woking model. Neither is it clear how readily such services would be offered or taken advantage of.

Application of Exemption Order 2001

- The group discussed the exemption order and it was reiterated that the Order was not designed with DE in mind. The participants were broadly in agreement that there was a need to introduce more clarity into the Order. It was noted that there are some circumstances where schemes are wrongly interpreting the Order.

- One member argued that it was important to do more than just add clarity to the Order but that it could be used as a vehicle to encourage DE.

- It was also noted that there is asymmetry between the exemptions arrangements for Generation and Supply. In the latter case, virtually all suppliers supplying off-site are above the exemptions limits.

- Another member noted that the group exemptions arrangements should be reconsidered to allow the large vertically integrated companies to finance DE projects.

Arrangements for Next Meeting

- Ofgem suggested that workgroup participants should prepare papers for discussion at the next meeting.

- EDF and LCCA agreed to provide papers.

Actions	**Person/By**
1. Send comments on discussion paper to Rachel Fletcher by 20 July	**All**
2. Send participants' papers for the next meeting to Rachel Fletcher by 3 September.	**All**
3. Send details of any other DE schemes to Rachel Fletcher.	**All**
4. Send Rachel Fletcher details of CHPA's code of practice.	**Allan Jones**

Date of next meeting

- The next meeting will be held at Ofgem on 10 September at 2 pm.