



Promoting choice and value
for all gas and electricity customers

Distributed Energy Working Group

16 October 2007

Agenda

- Introductory remarks and purpose of meeting
- Discussion Paper 3: Supply licensing and exemptions
 - Key challenges for DE schemes
 - Options to address challenges:
 1. exemptions
 2. becoming a licensed supplier
 - Provision of agency services
 - Other issues and possible measures
- Closing remarks and timeline from here

Introduction and Purpose

- Have now had 3 working group meetings, visited a number of DE schemes, and held bilateral discussions with interested parties
- Problems/barriers with the existing arrangements have been widely canvassed and debated – along with thoughts on solutions
- Purpose of current meeting – to have an open debate (“without prejudice”) on proposed measures, to help inform our consultation document later in the year
 - it must be stressed that no commitments are being made on consultation proposals at this stage

Discussion Paper 3

Key challenges for DE schemes: Supply licensing and exemptions

- Discussions with DEWG members and industry to date have highlighted four key challenges
- Scale:
 - energy supply a high volume/low margin business
 - planning requirements may encourage small on-site generation
 - CHP plant usually scaled to heat requirements – is the scale of electricity production efficient vs heat only?
- Cost of market and regulatory arrangements:
 - claimed to add 30% to costs of exempt supplier (not substantiated)
 - value of elec varies depending on where produced and consumed

Key challenges for DE schemes cont

- Cost of becoming a licensed supplier:
 - LCCA suggest this can add 1.6%-2.1% to capital costs
 - main costs relate to RO buyout (for non-renewable schemes), BSC, and MRA
- Costs and risks of operating in a competitive market:
 - schemes run on public wires face competitive pressure from other suppliers – may undermine economics of scheme
 - can these risks can be managed, eg through long-term contracts and acquisition of new customers?

Q: *Is this a fair characterisation of the key challenges facing DE schemes?*

Routes to market (1) – raising exemption limits

- **Why?**
 - Raising exemption limits transfers costs and complexity of market and regulatory compliance to licensed third party
- **How?**
 - Additional conditions could be imposed to address concerns, eg:
 - Requiring DE schemes to register for exemption
 - Limiting the number of customers outside the market
 - Time-limited exemptions
 - Attaching price/service benchmarks to exemptions

Raising exemption limits (cont.)

- But, a number of issues still remain with the exemption limits option:
 - can consumer protection be maintained vs competitive market?
 - does raising limits simply move the problem to another level?
 - is the Order fit-for-purpose if DE becomes more widespread?
 - should the limits apply to all suppliers or be specific to DE?
 - should licensed suppliers be permitted to participate in exempt supply?
 - should the per company maximum limit be removed?
 - how would the Order be policed?
 - can supply limits be raised without amending distribution limits?

Q: Have we captured all the issues associated with raising the exemption limits? What are the DEWG's views on these issues?

Routes to market (2) - Becoming a licensed supplier

- DEWG has also been considering how the benefits of being an exempt supplier might be replicated within the licensing framework
- The following suggestions have been put forward:
 - allow for the delegation of the high-cost high-competency aspects of the Supply license to third party agents
 - ensure the provision of agency services in the market
 - introduce a threshold for the RO
 - prevent customer switching for a period of time [from the inception of any given scheme]
 - remove the option of exemption for DE schemes / market participants, in order to encourage market for agency services

Q: *Is this a fair summary of the options to facilitate DE schemes becoming licenced suppliers? Are there other possible steps?*

Becoming a licensed supplier (cont.)

- There are a number of issues with this approach that need to be considered:
 - what would be the impact on the rest of the RO if certain suppliers are given an opt-out, and how the limit would be set?
 - would the possible inclusion of an objection clause in the license apply to all suppliers or just small DE schemes?
 - is an upper limit required on opt-outs? should it be time limited?
 - is the DE scheme developer likely to want a separate distribution licence as well as the supply licence?

We have not addressed all the complex implementation issues in our paper. We would however welcome comments on our analysis at this stage.

Provision of agency services

- Under **both** routes to market, there is a requirement for trading, pricing, settlement [and billing] services for DE schemes
- In determining what services are required and how they would be provided, the following issues need to be addressed:
 - the scope of services required?
 - role in balancing demand (buy/sell vs facilitating BSC compliance)?
 - how would the agency be paid for?
 - are single or multiple agencies required?
 - would the agency need to be regulated?
- There are also a variety of implementation options, including **market delivery**, **supplier obligation**, and **tender**

As with the licensing option, we have not addressed all the implementation issues with an agency model and further consideration is necessary. However we welcome feedback from the DEWG at this time.

Other issues and measures

- Other significant issues have been identified:
 - ensuring fair access to public networks
 - realising the value of embedded benefits
 - ensuring a competitive market for exports and imports
 - addressing issues around the balancing mechanism
- Our initial view is that in most cases:
 - highly technical nature of the issues may require longer timescales
 - other existing groups rather than DEWG better placed to pursue
- We have however sketched out some initial thoughts on measures to address these other issues

Other issues and measures (cont.)

- Possible measures that could address these issues:
 - Obligation on suppliers to pass through DUOS charges at cost for use of public network to secondary demand sites
 - Ensure LLFs consistently enable schemes to recover their embedded benefits
 - Encourage cost reflective DUoS charging
 - Encourage single price (or smaller spread) for cash out
 - A new market for trading export and import requirements

We welcome DEWG feedback on whether we have correctly identified the other important issues with the arrangements, and on the validity and feasibility of our suggested measures

Conclusions

- Not clear that raising exemptions solves a specific problem
 - merely moves the problem elsewhere (i.e. third party suppliers higher up the scale)
- It may be possible to finesse licences to facilitate DE
 - but requires Ofgem and Government intervention (i.e. Competition, RO)
- Other measures required to support DE:
 - provision of agency services, new DE/small gen wholesale market(?), revised network charging

Way forward

- Propose to make today the final DEWG meeting
 - unless WG has other issues they want to raise
- Consultation document
 - aiming for end November, [12] week consultation period
- Development of other measures in the interim
 - will seek participation from industry as necessary

The logo for Ofgem, consisting of the word "ofgem" in a white, lowercase, sans-serif font, centered within a solid orange rounded rectangle. The background of the slide features a collage of images: solar panels on the left, a hand holding a document on the right, and a close-up of a gas meter at the bottom. A dark blue header bar is at the top.

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