Cofely District Energy Response to Ofgem's Consultation on Third Party Access Charges for Licence Exempt Distribution Networks, on behalf of:

- Cofely District Energy Limited

- Southampton Geothermal Heating Company
  A partnership between:
  Southampton City Council & Cofely District Energy Limited

- Birmingham District Energy Company
  A partnership between:
  Birmingham City Council, Birmingham Children's Hospital NHS Foundation Trust, Cofely District Energy Limited, Aston University

- Bloomsbury Heat and Power

- Leicester District Energy Company
  A partnership between:
  Leicester City Council & Cofely District Energy Limited

- Cofely East London Energy
  Operating under concession to the Olympic Delivery Authority and Stratford City Developments Ltd.

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THE QUEEN'S AWARDS FOR ENTERPRISE: SUSTAINABLE DEVELOPMENT 2008
Awarded to Utilicom, the old name for Cofely District Energy

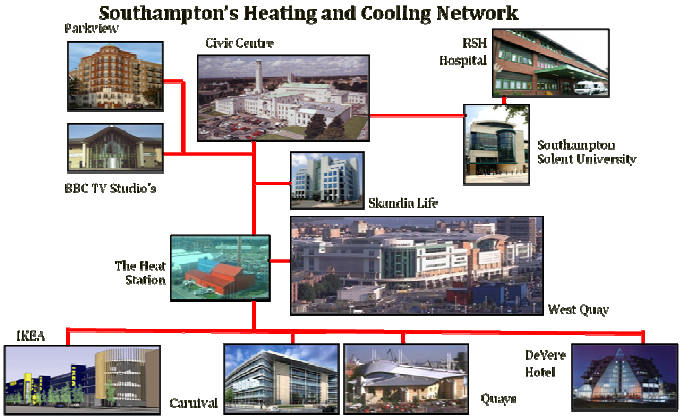
Summary of Cofely District Energy Limited's Response

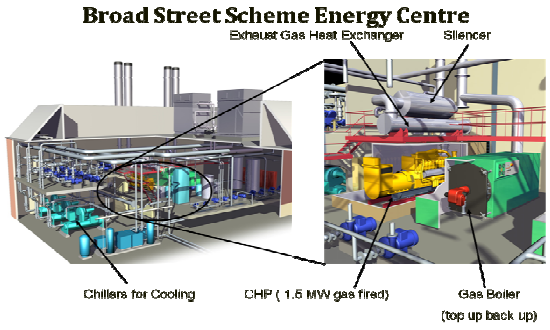
Cofely District Energy is a nationwide energy services company (ESCO) operating both large and small scale district energy schemes, utilising low carbon energy generation technologies. Cofely District Energy forms part of Cofely's UK Energy Services business stream, which is a part of GDF SUEZ, one of the leading energy services companies in the world. GDF SUEZ holds a corporate vision of delivering the "Cities of Tomorrow" with an integrated approach to energy, waste and environmental management.

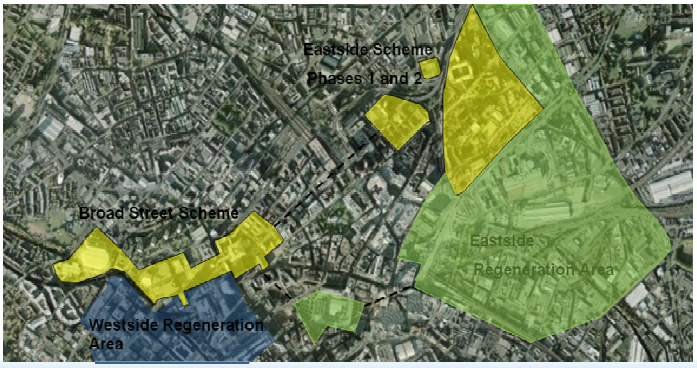
As GDF SUEZ's centre of excellence for decentralised energy, Cofely District Energy's schemes include:

- The Southampton District Energy Scheme
- The Birmingham District Energy Scheme
- The London Olympic Park and Stratford City Scheme
- The Whitehall CHP Scheme

Cofely District Energy is proud to be the UK's leading district energy company. Cofely District Energy's schemes range in size from city centre wide, such as the prestigious Southampton and Birmingham District Energy Schemes, to smaller schemes, such as the community heating scheme at Equinox in Hatfield and the Eastleigh Borough CHP scheme in Hampshire.







Question 1: Do you have any views on the proposed principles that will underpin ENOs' network charges?

The consultation document acknowledges the diversity of the licence exempt sector and engagement with its varied interests is important for developing guidance which works effectively to support access to the various applications of private wire in the UK.

Despite the light touch approach which allows exempt energy network operators to propose their own access mechanisms, the proposed methodology to be followed is too prescriptive. Regarding the effects on low-carbon decentralised energy generation in particular, the methodology does not give any regard to investment in items of plant that are related to and reliant on the energy network in question (such as small scale low-carbon plant).

The ability of a private energy network operator to choose, in a less prescriptive manner, how it prices access to its networks is key to the potential for success of these proposed changes, if the changes are not to adversely impact decentralised energy schemes on which the UK relies to help meet its energy and environmental targets.

The funding of decentralised energy schemes and private wire networks on which they depend, is secured on the bankability of long-term energy supply contracts with their private wire consumers. If the revenue stream from such long-term contracts is threatened (such as by a requirement for third-party access to private wire networks) then the 'bankability' of these energy supply contracts is harmed. A requirement to allow third-party access to private wire networks therefore has significant potential to disrupt the funding of decentralised energy schemes, unless the long-term revenue streams of such private network operators are protected.

In our view, ensuring that an operator of a private wire network is able to receive (at a minimum) equal revenue from third party suppliers as it would from selling directly to the network's consumers, would ensure continued financial viability of the network and satisfy the requirement to allow third party access. This idea links into the proposed requirement that the tariffs must not favour one user over another; payments by energy consumers connected to a low-carbon energy network go towards not just *network* costs but also the costs (capital & operational) of connected generation plant. All of these costs are often intrinsically linked as part of a unified decentralised energy system, with a single provider, and therefore cannot be 'unbundled'. As a result, it is appropriate that all consumers connected to the network should contribute towards the recovery of the total capital expenditure on which the low-carbon energy scheme is built, regardless of each consumer's supplier.

Referring to figure 3.1 in Ofgem's consultation ("The Elements of ENO Allowed Revenue") Cofely District Energy agree with the individual elements, but stress that, in the case of decentralised energy schemes, these elements cannot be separated out for the network alone but instead should be considered for the entire energy scheme, including the financing and operation of any connected low-carbon plant.

Following the "commercial arrangement" methodology discussed by DECC in their October 2010 consultation document[1], any third party supplier wishing to supply energy to consumers on a private network could be obliged to purchase electricity at a rate which protects the investment in associated low-carbon plant. This satisfies the requirement for third party access without detriment to greenhouse gas emission reduction targets.

As an example, an operator of a decentralised low-carbon energy scheme might normally sell electricity directly to a connected consumer at a price which is 5%-10% below that consumer's typical retail price for grid electricity supplies. If that consumer switches to a third party supplier, the operator of the decentralised energy scheme then has to sell that volume of energy at the (significantly lower) wholesale price, either to the third party supplier or exported to the grid. To bring the scheme operator's total revenue up to the same level as they would otherwise receive directly from the consumer (and therefore ensure that viability of the scheme is maintained) an additional charge to the supplier for network access and distribution needs to be levied, thereby meeting the need to recover capital investment and operational costs related to the decentralised energy scheme as a whole (i.e. both the energy network and the low-carbon generation plant). This headline methodology has been demonstrated in the attached chart at Appendix 1.

It seems likely that many mechanisms could be developed to calculate this network distribution and access charge but any potential mechanism must recognise that operators of licence exempt energy networks often require the networks for purposes beyond just operation of the network alone. Without the ability to recover a 'retail value' for power, investment in decentralised low-carbon plant will often not be viable or possible. To be completely clear, to protect investment in new decentralised low-carbon energy schemes, as well as the viability of existing schemes, the internal rate of return of the entire scheme must be protected. It is not sufficient to consider only the costs associated with the electricity network; where the electricity network is an integral part of the success of a decentralised low-carbon energy scheme, its share of the energy scheme's costs cannot realistically be separated and therefore the separate accounting required is neither possible nor appropriate.

Consideration of decentralised, low-carbon generation associated with the licence exempt networks which connect such generation to their energy loads is essential, if such schemes (particularly CHP and other low-carbon generation technologies) are to continue providing the same level of environmental benefits.

[1] DECC's Consultation on the Provision of Third Party Access to Licence Exempt Electricity and Gas Networks.

Question 2: Is the common methodology we have proposed proportionate? Is further guidance required on particular issues?

Cofely District Energy are particularly concerned that (the challenges of evidence collection notwithstanding) there has been no Impact Assessment undertaken for the effects of these changes on sustainable development and the environment. Licence exempt private wire networks are frequently used to distribute electricity to consumers from low-carbon sources of generation, such as combined heat & power (CHP) schemes. We therefore urge Ofgem to seriously consider the effects that access to licence exempt electricity networks will have on these low-carbon energy systems and ensure that the third party access and pricing arrangements avoid irreparable damage to the viability of current and future decentralised energy schemes. Failure to do so could mean a substantial reduction in the UK's ability to meet the nationwide need for widespread implementation of decentralised energy. A worked example demonstrating how the viability of decentralised energy schemes can be affected is provided at Appendix 2. Considering Ofgem's "need to contribute to the achievement of sustainable development"[2] in a manner which is "best calculated to ... secure a diverse and viable long-term energy supply" with "regard to the effect on the environment"[3], Cofely District Energy proposes that Ofgem ensure the true costs to low-carbon energy schemes, of third party access, are mitigated against, rather than only the costs relating to the energy networks alone.

Consumer energy cost savings for recipients of decentralised energy supplies are frequently bound into supply agreements by indexation mechanisms, to protect consumers from unfair price rises. However, even if demonstrable energy cost savings are achieved (when comparing supplies of low-carbon energy via licence exempt networks against conventional energy supplies) these cost savings do not *guarantee* that consumers will continue to consume energy from the low-carbon network, under the currently proposed access arrangements. In particular, such consumers may be vulnerable to unsustainable 'predatory pricing' practises. It is important to note that even a remote chance of lost consumers significantly damages the *bankability* of energy supply agreements, on which the investment in the low-carbon plant and energy network is based.

Since the forthcoming legislation is likely to impact on many low-carbon decentralised energy schemes, which often operate with extremely tight margins, it is therefore important that DECC and Ofgem introduce legislation, methodologies and guidance which is as "light touch" as possible, and Cofely District Energy is pleased to see that this has been recognised by both DECC and Ofgem. Any administrative burden imposed by changes in legislation must be minimised to restrict damage to the viability of decentralised energy schemes which contribute significantly towards the UK's carbon abatement targets.

Unfortunately, the requirement for separate accounting arrangements to be in place for determining use of network charges means that there is potential for very substantial administrative burden to occur and this requirement would therefore not appear to meet the need for the "least burdensome solution". This need to separate out the particular costs of network operation alone is clearly more appropriate for larger scale, *unbundled* systems and is not necessarily appropriate for smaller scale licence exempt networks with associated low-carbon energy supply systems.

[2] Appendix 3, Section 1.7 of Ofgem's Consultation Document.
[3] Appendix 3, Section 1.9 of Ofgem's Consultation Document.

Question 3: Is our proposed approach appropriate? Are there other arrangements which could be put in place and would help the sector comply with the obligations?

Cofely District Energy would like to re-iterate that any administrative burden imposed by changes in legislation must be minimised to restrict damage to the viability of decentralised energy schemes which contribute significantly towards the UK's carbon abatement targets. Whilst this has been recognised by both DECC and Ofgem, it is important to note that the current proposals do incur the potential for substantial administrative burden on small scale network operators. They therefore do not appear to meet the need for the "least burdensome solution". Changes are required to the current proposals to genuinely enable affected network operators to comply with their obligations; please refer to our response to Question Two for the full details of our concerns in this area.