

Offtaker of Last Resort Advisory Group – Fifth Meeting
Wednesday 27th November 2013 15:00 – 17:00
Minutes and actions

Attendees:

DECC attendees:

Tim Warham (chair)
 Alex Weir
 Darryl Croft
 Matt Coyne

Adam Harper
 Helena Crow
 Michelle Toussaint-Bourne

Advisory Group attendees:

Christian Pegrum, Eon
 Ravi Baga, EDF
 Christian Milhan, Ofgem
 Phil Broom, GDF Suez (by phone)
 Stuart Noble, Scottish Power (by phone)
 Dima Rifai, Paradigm Change Capital Partners LLP (by phone)
 Keith Patterson, Brodies (by phone)
 Edward Crosthwaite Eyre, Baringa
 Chris P. Collins, Baringa

Apologies:

David Handley, RES
 Martin Bell, Ofgem
 Maria Paz Garcia Alajarin, EDP Renewables
 Andrew MacLellan, Energos
 Charlie Garrood, PwC
 Simon Proctor, Good Energy
 Konstantin Suplatov, PwC
 Ben Cosh, Green Company
 Nick Gardiner, BNP Paribas
 Robert Owens, Smartest Energy

1.	Cost Assessment	Paper 5.1: Cost Assessment	Adam Harper	
<p>After introductions, Adam Harper (AH) presented paper 5.1 on the proposal for Cost Assessment in the Offtaker of Last Resort mechanism (OLR). The group discussed questions that were raised in the paper.</p> <p>Q1: Do you agree that the risks to offtakers and/or consumers of using a regulatory cost assessment is likely to be too high?</p> <ul style="list-style-type: none"> There was consensus in the group that the complexities of a regulatory cost assessment approach, and the consequent risks of over or undercompensating offtakers, meant that this 				

mechanism is unlikely to be a practicable or economically viable option. DECC will test this further with smaller suppliers.

Q2: Does the group agree that a purely competitive process could be bankable?

- The group agreed that a competitive process could be bankable, as the floor price on CfD terms could be guaranteed. The group agreed that, under a competitive process, a generator could be allocated to a backstop offtaker fairly quickly.
- The group questioned how eligible generators would be allocated under competitive allocation if there were no bids. AW explained that certain credit-worthy suppliers with significant market share would be compelled to submit bids as part of their supply licence conditions; while other parties, such as aggregators, could make voluntary bids. The levelisation process should ensure cost-reflective bids.

Q3: Do you agree that

(a) a 'no regrets' notification period of 2-3 months would not increase the collateral requirements in open market PPAs; and

(b) offtakers should be able to determine what bids to make in a competitive process within the space of a week?

- The group discussed no regrets notification periods, where generators would have to inform Ofgem that a backstop PPA may be needed, but would still be able to withdraw their request without penalty. The group judged that a 3 month 'no regrets' period before a 'commitment period' could be an appropriate length.
- However the group raised a concern that the 'no regrets' period could encourage spurious notifications with a considerable administrative burden for Ofgem, as generators could notify when they knew their PPA was due to expire even though they may not need to access the OLR. The administrative burden on generators of repeatedly notifying could provide sufficient discouragement to this.
- The group felt that a two week 'commitment period' before the allocation - in which the generator would be *obliged* to enter the backstop PPA - would be sufficient for offtakers to price bids. Offtakers may need to have some sort of standing approval process in case time was short, but judged that two weeks was an appropriate length of time to price bids.
- The group questioned what Ofgem would be required to do having received a generator's notification. AW outlined the processes that Ofgem may have to undertake, including activating systems; processing the notification; notifying suppliers that a generator needed a PPA; supplying accompanying information (company structure; generation history) and identifying additional information that suppliers may require to assess bids.
- The group indicated that they thought the competitive allocation process should be standardised as much as possible and supported following a Supplier of Last Resort approach. In this approach a standard contract with standard terms would be issued with space for key inputs and the price calculated on the basis of these standard inputs.
- The group felt that room should be left for making minor modifications to the allocation mechanism, accepting that there may be scope to improve the process following the initial allocation of the first backstop PPA.
- Another option proposed by the group was to carry out a quick process for a shorter tenor initial backstop PPA. Then at standard intervals during the year if PPAs were needed, these could be batched and auctioned off for a longer tenor.
- The group also pointed out that generators would have to notify banks that they were

accessing the OLR. Banks could also place conditions on generators to notify their intent to access the OLR, direct them to enter the OLR and/or could set deadlines to protect themselves against equity and against generators changing their minds.

Q4: Do you agree that the risk to consumers from uncompetitive auctions is mitigated by the factors outlined above?

- The group highlighted the risk that there could be high bids that were not cost reflective and that this could be an indication of gaming or uncompetitive behaviour in the market, but that this risk should be offset by the levelisation process.

Q5: Do the group agree that a purely competitive allocation mechanism has potential, and should be worked up in more detail?

- There was consensus in the group that a competitive allocation mechanism should be considered in greater detail.

Q6: Do the group agree that a reserve power to allocate generators on a regulatory basis should be retained if pure competitive allocation is implemented?

- It was put to the group that with clear principles, reserve powers could be workable. If the market became uncompetitive with, for example, only two big suppliers, sealed bids could be a solution. However, the group pointed out that this scenario would imply that there was market failure and that competition authorities should already have acted to alleviate this issue.
- The question was asked whether reserve powers were already held by one of the existing bodies to act to combat uncompetitive behaviour. DECC will investigate these options further.
- The group raised the point that some flexibility and competition could be lost by having these reserve powers. The view was that extra protections may not be good for the market and that the existing protections built into the OLR mechanism' for example through levelisation, should be sufficient.

2.	Levelisation	Paper 5.2: Levelisation	Darryl Croft	
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Darryl Croft (DC) presented paper 5.2 on the proposed Levelisation options for the off-taker of last resort mechanism.

The following points were raised in the discussion:

Q1: Do you agree that all licensed suppliers should be obligated to participate in the levelisation process?

- There was general consensus on this question with participants agreeing that the proposed levelisation options in the paper were fair in terms of retail market competition.
- The group proposed that there could be greater transparency in the market if OLR levelisation costs were published. ssFIT currently publish costs but these costs are retrospective and subject to adjustments so not viewed as fully transparent. Publishing would allow fairer representation of costs to customers.

Q2: Should a fixed payment to each offtaker be included to cover administration and other fixed costs associated with being a backstop offtaker? How should such a sum be calculated?

- The group proposed that the process should be as simple as possible; fixed payments would introduce unnecessary complexity since, under a competitive allocation approach, fixed costs could be included with any bid.
- It was noted that no small suppliers were present who might hold a different view and DECC agreed to follow this up further with them.

Q3: Should Ofgem's costs be recovered from the OLR levelisation fund?

- The group acknowledged that under the ssFIT, Ofgem's costs are added to the amount to be levelised across suppliers. However, under the OLR, this may not be appropriate: Ofgem may incur costs in administering the OLR over long periods of time when backstop PPAs are not being issued. The group also thought that there shouldn't be any volume load associated with the backstop PPA, so it should incur little or no additional costs for Ofgem. It may therefore be preferable, and simpler, for Ofgem to cover any costs themselves. DECC will follow this up further with Ofgem.

There was discussion on how 'market share' would be determined:

- Market share used in the levelisation process will be calculated based on suppliers' retail market supply volume. There will be a £/KWh charge, recovered across all suppliers.
- A question was raised over the exemptions for CfD costs for energy intensive sectors within the Supplier Obligation – whether these sectors would be exempt from OLR costs. DECC will investigate this issue.

Q4: Do you agree that costs (and profits) should initially be levelised quarterly, and adjusted if there is high utilisation of the OLR mechanism?

- The group proposed that because there are parallels with the CfD payment flows process, it may be possible for OLR levelisation to become part of the settlement process that industry will follow for CfDs – the Supplier Obligation (SO). This might present a simpler approach since the SO data would flow through Elexon who would be needed anyway to provide information on generation volumes under BPPAs. The SO charges exempt some sectors from CfD payments, though it might be possible to share the OLR costs differently if it was felt that these exemptions shouldn't apply to the costs of the OLR.
- The group felt quarterly levelisation was reasonable if the SO couldn't be used to levelise OLR costs.

Q5: Do you agree that mutualisation provisions are included, with a cap and collar? If the cap is breached, should we allow payment in instalments?

- Again, the group felt that these requirements would not be needed if included within the CfD Supplier Obligation, since payments are settled daily.
- In the event that the SO was used, the group questioned whether the mutualisation provisions could be negated in favour of using the CfD reserve funds. AW explained that it is different approach, and OLR Offtakers need less protection than the CfD Counterparty Body: the Counterparty Body has no other source of revenue so needs a reserve fund to protect payments to generators; however backstop offtakers have other sources of revenue and are not dependent solely on the payments from the levelisation fund.

- It was noted that there may not be the need for cap and collar if the OLR can use the CPB settlement process. DECC will look further at using this option for the OLR.
- The group considered whether there should be a different cap. DC raised the point that there may be the need for a cap. For example if a supplier goes into liquidation owing money to the levelisation pot, other suppliers will have to pay to cover this supplier. This may have a domino effect with other suppliers going into liquidation, therefore supporting the need for a cap. The group suggested that DECC speak to smaller suppliers and aggregators about this issue.

Q6: Do you agree that we should not require suppliers to post collateral to the levelisation fund?

- The group generally agreed that holding extra collateral would not be required, although they asked for further opportunity to consider this once the payment model for CfDs has been finalised.
- The group were interested in whether levelisation would be covered by the Special Administration regime. If so, this would increase the credit worthiness of levelisation.

3.	Forward Look		
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It was acknowledged that this was our final scheduled OLRAG meeting. Over the next few months the team will be clearing policy decisions internally, writing our consultation document and developing the Impact Assessment. The possibility of a wrap-up meeting was put to the group and the feeling was that a meeting to discuss a strawman collating the emerging positions and reflecting the outcomes of the OLRAG meetings would be helpful. This would be in late December or early January, by which point the CfD contract is expected to have been published.