Off-taker of Last Resort Advisory Group – Conclusion Meeting
Tuesday 7th January 2013 16:00 – 17:00
Minutes and actions

Attendees:

DECC attendees:

Tim Warham (chair)
Darryl Croft
Adam Harper
Helena Crow
Michelle Toussaint-Bourne

Advisory Group attendees:

Martin Bell, Ofgem
Dave Handley, RES
Ravi Baga, EDF
Andrew Maclellan, Ener-g
Christian Pegrum, EON
Phil Broom, GDF Suez
Charlie Garrood, PWC
Dimitria Rifai, Paradigm Change Capital Partners LLP
Keith Patterson, Brodies
Lars Weber, Neas Energy

Apologies:

Simon Proctor, Good Energy
Nick Gardiner, BNP Paribas
Robert Owens, Smartest Energy
Konstantin Suplatov, PwC
Ben Cosh, Green Company
Stuart Noble, Scottish Power

	OLR Overview	**Darryl Croft**	

After introductions, Darryl Croft (DC) outlined the latest high level design and DECC's minded-to positions in preparation for the OLR consultation.

Eligibility

Darryl explained that the proposed eligibility criteria have changed since the initial proposal at the OLRAG, reflecting feedback from the group. We will be consulting on making the OLR accessible to all technologies and all sizes. The allocation of larger generators may be split into 100MW tranches to maximise competition amongst offtakers.

The group was asked whether pursuing the Metered Volume Reallocation Notification (MVRN) process for splitting output from larger generators into smaller tranches had merit if competitive allocation was the preferred allocation approach. The following points were raised in the discussion:

- The group clarified that in competitive allocation larger suppliers (mandatory offtakers) would be obliged to bid for all tranches and, if capacity was split, they could bid for different tranches with a different price for each tranche.

- The group discussed that, if we decided not to split larger generators' output between several offtakers, then there would only be a limited pool of offtakers capable of handling them. This could severely limit competition amongst offtakers, which is essential for ensuring that generators and consumers get the best deal possible. It could also put a disproportionate amount of credit risk on the small pool of offtakers capable of managing the output from these larger generators.

The group therefore agreed that splitting output for larger generators could increase competition. The group did not think that this could risk increasing bids since there are not economies of scale beyond 100MW.

Offtaker Identity

DC explained the options for determining offtaker identity where suppliers with the largest percentage share of the supply market would be mandated to offer/bid for OLR PPA contracts and smaller suppliers could voluntarily bid for contracts subject to specified credit requirements. Other offtaker identity options were: requiring mandatory offtakers to have an established presence in the UK market; having a percentage of electricity supply volume; ranking suppliers by volume and those having a cumulative share of x%; suppliers with at least a 10% share of UK market would be required to bid; and the SoS would review the scheme if there was a high level of fragmentation leading to many small suppliers; and ensuring lenders were assured that there was always an offtaker to bid for contracts.

The following points were discussed:

- The group agreed with the proposed options to identify offtakers using their percentage share of the supply market.
- The group thought that credit ratings were critical especially from a finance perspective and were intrinsic to the bankability of the scheme.
- There was agreement that all potential offtakers should be subject to the same credit requirements. This would be of importance to generators who may not know whether they would be allocated a mandatory or voluntary offtaker. It would also be important so as not to distort the offtaker market.
- The group referred to work completed by the wider EMR team demonstrating the risk of suppliers defaulting as being low. The group generally preferred BBB+/A- credit ratings demonstrating an offtaker was investment grade. However, it was pointed out that when looking at the current market conditions, some of the larger suppliers had a rating of BBB/BBB+. The group thought that these lower credit ratings could still be acceptable provided another Backstop PPA could be put in place quickly in the event of a supplier defaulting.
- There was a concern that some European utilities with investment grade credit ratings and an established PPA presence wouldn't be covered by the mandatory requirements. DC explained that these entities could bid as voluntary offtakers.
- The changing of A.BMUs takes Elexon two to three months, potentially lengthening the OLR allocation process. DC explained that DECC is working with Elexon to solve the A.BMU issue for embedded generators under the CfD and for the OLR.

Access

After presenting the options on Access to the OLR, DC confirmed that a generator could access the OLR from the first day of a CfD being signed.

- Questions regarding information requirements still need to be answered but the information on Access to the OLR remains the same as presented and in papers from OLRAG 3. The group generally agreed with the policy options outlined.

Allocation

DC outlined that there will be a purely competitive approach; contracts would be allocated to those who bid the least; contracts would be in place within six weeks; a sealed bid process would be run by Ofgem initially, but giving Ofgem flexibility over how they allocate the contract.

The following points were raised in the discussion on allocation:

- Concerns were expressed that a six week allocation period could mean generators lose two and a half months of revenue when trying to access the OLR, as they are paid a month in arrears. But the group pointed out that even though the OLR allocation processes were taking place the generator could still spill their output.

- The group expressed concerns about Ofgem determining the contract allocation process and the guarantee that contracts would be allocated in time. DC explained that DECC were discussing options for putting duties on Ofgem to allocate contracts within six weeks and whether a KPI would give generators comfort.

- MB explained that Ofgem would not be determining the contract allocation process on a case-by-case basis and that there would need to be a clearly established processes which would be reviewed periodically to ensure the mechanism remained efficient and would not be subject to adhoc change. Ofgem have demonstrated experience by successfully administering the Supplier of Last Resort, illustrating competence administering similar schemes and allocating contracts quickly.

- The group expressed the need for the sealed bid process to be clearly spelt out so that banks could be more comfortable with the process and go through their internal clearances.

- The group ran through the contract allocation steps: assessing bids; Elexon processes; receiving sealed bids from offtakers; timing of responding to the request; verification of bids; starting contract processes; and concluded that six weeks was a reasonable timeframe.

- The group identified the difference between the system sell and system buy price and explained that the difference between these in future may lead to banks having no income for six weeks and they may have to shut the plant in this time. This could be a reason for a generator needing six weeks of cash reserve, at least at the start of the OLR scheme.

- The pricing of the offtaker bid was discussed and the group stated that bids should be firm bids and the pricing of the bid may be a board decision. Banks and offtaker boards would need to know what approvals system would be needed or they may default to having a standing bid which may not be the best bid.

Levelisation and cost assessment

DC confirmed that the levelisation and cost assessment options would be as outlined in the paper from OLRAG 5.

- DECC are resolving issues such as the potential need for the OLR to immediately use the CfD settlement process; difficulties integrating a daily settlement process (when the OLR may not be used for several years), the discussion on fixed or variable levies; the necessity to review these processes as the scheme develops; and the Energy Companies Administration regime protecting supplier default versus the value of a cap on mutualising a shortfall. We will consult on these options.

- The group did not have any questions or raise any issues regarding the levelisation process.

Pricing

DC briefly outlined the options for pricing the backstop PPA discount and explained the modelling options.

- DECC will consult on a range of prices for the OLR discount, but with a favoured option.

- The group pointed out that a single discount may not be reflective of imbalance cost or different technologies. DC explained that the proposed discount is set against the technologies most likely to use it (offshore wind and other intermittent technologies).

- DC explained that the modelling aimed to find an OLR discount whereby project returns would be similar under long-term and short-term contracting strategies. Under the short-term strategy, gearing is reduced, but discounts are lower. At an OLR discount of £25/MWh returns were similar between the contracting approaches. DC added that DECC have not yet seen any evidence to support separate discount prices for different technologies, but that any evidence submitted in response to the consultation will be considered.

- The group did not have any further questions.

Contract Terms

- Questions were raised by the group on curtailment and whether it is a requirement on offtakers to curtail if for example a generator in the OLR was losing money. It was thought more cost effective to stop generation. It was clarified that curtailment options and duties would be included in the terms of the Backstop PPA Contract.

- TW asked the group whether they thought curtailment should be a condition in a bPPA. The group widely agreed that this should go into the contract but it was pointed out that some technologies were easier to turn off/on than others.

Scheme Review

- The group expressed concerns about information requirements such as what information generators should submit; how information submitted by generators would be protected for example from FOIs; the extent to which commercial sensitivities would be considered; who required pricing information, Ofgem or DECC. DC proposed that there would be a standardised form submitted to DECC or Ofgem but this would be a consultation question.

• The group suggested that FOIs could be avoided and that information could be anonymised before submission. However, there were concerns about how we would know that all generators have fulfilled their information provision obligations if the information they submit is anonymous.			
4.	**Forward Look**		
Thanks were communicated to the group for their input into the OLR design process. The consultation will be published in February and responses to the questions raised would be greatly appreciated. We intend for the OLR secondary legislation to come into force around the time the first CfDs are allocated in Autumn 2014.			