



LICENCE LITE – STRATEGIC AND POLICY ISSUES

London's targets

The Mayor of London's Climate Change Mitigation and Energy Strategy (which recently completed its public consultation) sets a target for 25% of London's energy demand to be met from decentralised sources by 2025. For the purposes of this target, decentralised energy is defined as zero or low carbon power and / or heat generated and delivered within London.

Local power generation is an important feature of the target, since a significant proportion of the target is most effectively met through combined heat and power schemes. These may use a range of energy sources, including waste derived fuels and biomass. Initially, natural gas fired CHP may predominate, but they are anticipated to be replaced by renewable sources of generation.

A breakdown of the projected scale of decentralised energy projects required to deliver the Mayor's target is contained in the Mayor's Climate Change and Energy Strategy.

The development of decentralised energy (CHP) schemes in London

The deployment of heat network infrastructure in areas of dense heat use to distribute low or zero carbon heat generated from CHP schemes, makes efficient use of fuel sources, produces significantly less CO₂ emissions than conventional forms of energy generation and is flexible in the fuel sources that can be used. London, as with other densely built up areas of the UK, offers an environment in which CHP and heat networks can, when correctly sited, be the most cost effective means of providing low or zero carbon energy to a given area.

Within London there are currently some 20 projects approved or identified together having a potential carbon reduction of approximately 110,000 tonnes per annum. The London Heat Map, funded by the London Development Agency, identifies heat load densities across London. Some 23 London boroughs are putting in place the strategic mapping of potential projects within their areas. Of the six London boroughs which form the supervisory group for taking forward the licence lite project in London, all have schemes at different stages of development, ranging from feasibility to implementation.



The publication 'Powering ahead – delivering low carbon energy for London', jointly published in October 2009 by the Mayor of London, London First, London Councils and the London Development Agency, sets out the prospectus for the delivery of low carbon energy in London.

The role of electricity supply in optimising schemes

Particularly since the introduction of the New Electricity Trading Arrangements in 2001, smaller electricity suppliers have found difficulty in trading in the electricity market because the costs, risks and complexities of doing so are disproportionate to the size of their businesses. It was against this background that Ofgem produced its licence lite proposals in 2009.

The essence of the issue regarding electricity sales by small generators or suppliers is that unless there are exceptional considerations influencing the commercial relationship between a licensed supplier and a smaller generator, the price offered by the licensed supplier for the small packets of power involved reflects the poor negotiating position of the generator and (in general) the lack of financial interest on the part of the suppliers in purchasing the electricity. That should be distinguished from the purchase of derivatives, such as Renewables Obligation Certificates and Climate Change Levy Exemption Certificates which carry their own value. Work done by consultants appointed by the London Development Agency has demonstrated that if smaller suppliers were able to sell the electricity (as distinct from any derivatives that may be attached to it) direct to consumers at or even somewhat below prevailing retail prices, the effect, particularly on larger schemes, is to double or more than double the returns capable of being made after taking into account the estimated costs of sales. These costs include an estimate of all costs incurred in buying the necessary market interface and related services from a fully licensed supplier, as described in Ofgem's proposals.

Although it cannot be said with any certainty whether the cosy estimates used will reflect the tender prices offered by fully licensed suppliers, the results of the preliminary study justify pursuing the feasibility of licence applications and addressing the barriers that may be encountered in the course of doing so.

The enhanced net revenue estimated to be available under licence lite operation increases the number of schemes that are capable of earning adequate returns and have the potential to attract external investment. The reason is plain to see. Enhanced net electricity revenues enable the heat generating capacity to be operated more flexibly, if need be in the context of



more intermittent heat demand and also for the heat price to be more competitive.

Wider policy considerations

The importance of finding a means of successfully implementing Ofgem's licence lite proposals go substantially beyond the needs of the Mayor of London's own agenda, most notably –

- Similar considerations regarding the potential of decentralised energy schemes for cost effective carbon reduction apply to other conurbations with dense heat demand, apart from London.
- Because the ability to realise the proper value of decentralised electricity generation through direct retail sales gives scope for the price of the heat to be more competitive relative to other low or zero carbon solutions, the implementation of the licence lite proposals can make a positive contribution towards reducing fuel poverty.
- It is the Government's ambition to increase competitiveness in the electricity supply market and encourage new entrants. The successful implementation of licence lite is a significant move in that direction.
- Ofgem will be aware that the powers of local authorities have recently been extended to enable them to supply renewable electricity other than in the course of operating a CHP scheme. The implementation of licence lite will help local authorities use their new powers more effectively.
- The more the electricity market is adjusted to enable operators of zero carbon electricity generating plant to supply their electricity at optimal prices, the lower the need for external support through policy measures instigated by central government and ultimately paid for by consumers.



SUMMARY OF THE TERMS OF THE SUPPLIER SERVICES AGREEMENT

Parties

The parties to the agreement are the applicant for an electricity supply licence from which all or some of the requirements of Condition 11(2) are to be excluded (referred to as LL) and a third party licensed supplier who is a party to all the relevant codes (referred to as 'TPLS')

Warranties

A number of warranties are given concerning legal capacity and other matter. In particular each warrants that they have the resources to meet their respective obligations and in particular on the part of TPLS that it is party to all the relevant industry codes.

The Term of the Agreement

The draft includes an initial term of 5 years. However, a significantly longer term may be necessary if TPLS is dependent for example on project finance, in the absence of there being any stable market practice regarding the willingness of fully licensed suppliers to enter into these agreements on known price structures.

Service Delivery by TPLS

Details of the services to be provided are contained in Schedule 1. these may be divided into services which LL are likely to see as 'core' or mandatory and those that are more optional to LL, on the basis that LL may be in a position not to need such services. Examples of core services are the provision to LL of services relating to functions under the BSC or the MRA. An example of an optional service may be TPLS managing aspects of LL's customer billing requirements.

Core services are listed in Schedule 1, are largely recognised in Ofgem's guidance note and include the following –

- A general duty to provide information to LL and co-operate
- Compliance with specific codes, notably the BSC / MRA / DCUSA / CUSC (if relevant)
- Arranging and operating a use of system agreement with the distribution network operator (this need not include arranging connection agreements)
- Registration functions under the MRA



- Appointment of meter operator, data collector / aggregator. The agreement contemplates TPLS agreeing with its own meter operator and data collector and aggregator to enter into a collateral arrangement directly with LL, rather than LL's needs being met entirely through the interface with TPLS. This may be acceptable to TPLS, but may present problems to the agent.
- Customer transfer processes under the MRA. Terms are included to enable TPLS to place a block on customer transfer where LL is owed money by a transferring customer

The Capacity in which TPLS Delivers the Services

The Supplier Services Agreement provides that TPLS acts as LL's trustee in relation to the functions carried out by TPLS for LL's benefit under the relevant industry codes / agreements. The reasoning behind that is as follows:

- TPLS cannot technically act as LL's agent because LL as principal is not a party to the relevant industry agreements, so TPLS would need to contract as principal
- The property in the customer and the benefits / burdens flowing from that must however lie with LL.. A trustee relationship enables that to happen beneficially
- TPLS needs to owe a duty of care to LL. A trustee relationship is a suitable vehicle for that
- This relationship avoids any rule changes or consents from being required under the relevant industry codes.

Service Charges

The service charges (Schedule3) are broken down into their constituent elements. This is so that LL may, when comparing tenders for the services, be able to compare like with like and also be better able to evaluate charges quoted against likely underlying costs.

It is recognised that any licensed supplier may decline to enter into a Supplier Services Agreement with LL either under the terms of this form of agreement or at all. the way in which TPLSW may cost the services is also unpredictable and may be uneconomic for LL.

However, it was understood by the working group which constructed these proposals with Ofgem that the provision of the required services should first be left to the market, but would be subject to subsequent review.