

License “light” – is this the change DE has been waiting for?

Fontenergy

Level 2, 10 Stoney Street
London, SE1 9AD, UK
tel. +44 (0)20 7042 9270
fax +44 (0)20 7042 9271

Via delle Clarisse, 2
Perugia 06122, IT
tel. +39 (0)75 372 2751
fax. +39 (0)75 372 2751

info@fontenergy.com
www.fontenergy.com

Ofgem proposals to make it easier for distributed energy developments to operate as a licensed supplier on the public network.

A key issue in providing distributed energy to large schemes is the requirement to hold a license for electricity supply (and in some cases electricity distribution). For schemes over the license exemption regime (approximately 1000 homes) the energy services company must hold an electricity supply and distribution licenses.

Although the process for obtaining a license is straightforward, it sets a series of requirements on licensees, including signing and complying with a long series of industry codes. These codes require specialist energy staff to comply with and also require extensive IT systems. This results in potentially millions of pounds of start up costs as well as high levels of ongoing costs.

Ofgem plan to make this easier by allowing a revised form of electricity supply license (license light), where a licensee does not need to comply with the codes, provided that it puts in place alternative arrangements with a fully license supplier who is a signatory of all these codes. Effectively, provided the energy services company can sign a suitable agreement at reasonable cost, it can avoid millions of pounds of costs over the life of the energy services agreement.

This raises a number of questions for developers with sites over 1000 homes, particularly:

- A - With license light, can I operate as if I were an exempt supplier?
- B - Will any fully licensed electricity suppliers wish to enter into such an agreement to supply a contract to a license light party?
- C - Given the complexity of the likely agreement, how would you set about putting one in place and then administering it?
- D - What will it cost?

Does license light allow me to operate as if I were an exempt supplier?

License light will not resemble exempt operations with a service agreement. Although the proposals will turn off several license conditions, many remain in force. There are two key points:

- 1 - Energy flows will not be calculated based on the “boundary meter”
- 2 - Customers will be able to switch supplier in the standard way.

Exempt sites manage all the electricity flows within their area and then usually have a “top up and spill” contract to manage any difference between actual demand

Fontenergy

Level 2, 10 Stoney Street
London, SE1 9AD, UK
tel. +44 (0)20 7042 9270
fax +44 (0)20 7042 9271

Via delle Clarisse, 2
Perugia 06122, IT
tel. +39 (0)75 372 2751
fax. +39 (0)75 372 2751

info@fontenergy.com
www.fontenergy.com

and actual generation. This allows them to import to and from the wider electricity grid. Many exempt sites have sophisticated metering for all their customers and are able to monitor demand on a half hourly basis.

The electricity market requires small customers, such as households, to have a meter which records the quantity of electricity consumed over a period of time, but not when that electricity was consumed. To turn this into half hourly data, a customer profile is applied in which a customer is assumed to consume electricity a particular proportion of energy in each half hour relative to their overall consumption.

While this works well over a large portfolio of customers, on small sites it can leave a significant difference between actually consumed electricity and quantities recorded in settlement. Or in other words, your demand and generation on the site can match physically in a half hour period, but settlement will deem you to be out of balance because the generation and aggregate profile consumption did not match.

License light sites will be exposed to the full requirements for customer switching, although it is worth noting that the Citiworks ruling has upheld the customer's right to switch and so it will also become a requirement for exempt sites. It also adds a myriad of rules around issues such as customer charters, meter inspections, requirements to publish tariffs on price comparison sites etc, which exempt sites do not have to comply with.

As a result of all of these issues, license light will operate and contain a very different profile of revenues, costs and risks compared to exempt sites.

Will anyone offer terms?

Ofgem will not compel licensed suppliers to offer terms to license light parties. Given that the electricity market has six main suppliers and only a few small independent suppliers, the pool for potential contracting partners is extremely small.

Although a 1,000 home scheme would be considered quite large in the context of housing developments, they are extremely small in the context of the scale of the large supplier's customer base. Their systems are largely automated and would require modification to manage the requirements of the license light parties. As a result, the costs are likely to be high for a very limited return. We would be surprised if more than 2 or 3 parties show significant interest in developing and signing an agreement.

Fontenergy

Level 2, 10 Stoney Street
London, SE1 9AD, UK
tel. +44 (0)20 7042 9270
fax +44 (0)20 7042 9271

Via delle Clarisse, 2
Perugia 06122, IT
tel. +39 (0)75 372 2751
fax. +39 (0)75 372 2751

info@fontenergy.com
www.fontenergy.com

What arrangements are required?

Any agreement is going to cover three key areas: submission of information; dealing with imbalanced electricity volumes; and credit terms. An Ofgem document^A sets out greater detail on some of the terms which will need to be put in place.

An agreement for license light services will require the fully licensed party to submit information on your behalf to the industry. There are strict requirements about how information is submitted and within what time parameters, set out in the Balancing and Settlement Code (amongst the key industry code documents). This means that the license light party will have to be able to respond rapidly and potentially provide IT systems which can interface in an automated way with their agreement counterpart. This may well require a mini replication of the full IT systems as well as a detailed understanding of what the code requirements are.

In addition to suitable IT systems, a key part of the agreement will be imbalance charges. Licensed suppliers are required to ensure that, for each half hour, generation and supply match. If a party is not matched, then penalty prices apply. These prices are calculated each half hour and depend on the costs incurred by National Grid in keeping the system balanced. Imbalance prices, although generally reasonable, can become thousands of pounds per MWh – many times above the cost of own generation. A counterparty will look to pass back through any imbalance risk and it may not be possible to share in any of the portfolio benefits that the large suppliers have.

With potentially large volumes of costs associated with imbalance and other such charges, any agreement will have credit requirements. The ESCO will have to provide suitable credit terms under the agreement. Generally, credit is a significant issue for suppliers and we would expect to see credit being a difficult issue to negotiate.

What will it cost?

We would expect the first agreement, if produced from scratch, will cost tens if not hundreds of thousands of pounds of legal fees. In addition to that, most likely any agreement will require a significant investment in IT and staffing. Your counterparty will then require ongoing payments for services used. Having investigated, we are doubtful that the costs of being licensed light will be significantly different from fully licensed.

Fontenergy

Level 2, 10 Stoney Street
London, SE1 9AD, UK
tel. +44 (0)20 7042 9270
fax +44 (0)20 7042 9271

Via delle Clarisse, 2
Perugia 06122, IT
tel. +39 (0)75 372 2751
fax. +39 (0)75 372 2751

info@fontenergy.com
www.fontenergy.com

So how does this go forward?

Changing the license condition is the straightforward part of the process and provided that there are no significant objections, Ofgem will be able to make the necessary license condition changes to legally allow a license light regime to exist. Ofgem plans to form a working group to progress license light and also plans to monitor the market for two years to see if license light provision develops organically. Although technically possible in 2009, license light is unlikely to be a practical reality for at least another few years.

Distribution charges – changes to help distributed energy stalled.

Distribution charges are paid by both generators and customers connected to the distribution network. Charges vary by customer type and distribution zone. Ofgem, the electricity and gas regulator instigated a review of distribution charges to better reflect distributed energy.

Originally, OFGEM proposals were to include a 'short haul' tariff to bring in cost reflective pricing. This would have reduced the charges paid by distributed energy schemes connected to a distribution network (not a private wire scheme) to reflect the fact that generation and consumption occur locally. It would also have required cost reflective generation charges for distributed generation, which in some areas would have allowed generation to be paid (rather than pay) to be connected.

However, the package of changes was rejected by a number of distribution license holders and so changes cannot be implemented. Ofgem is currently consulting on whether to send the proposals to the Competition Commission. New proposals with cost reflective pricing for distributed energy are now at least two years away.(March 2009)