



Response to BERR/OFGEM Consultation

Proposals for More Flexible Market and Licensing Arrangements

July 2008

## **1 Response to Consultation Questions**

Fontenergy is pleased to have this opportunity to respond to the BERR/Ofgem consultation on Flexible Licensing Arrangements. We would be happy to discuss our response in more detail. If you have any queries relating to our response, please contact Isabelle McKenzie (isabelle.mckenzie@fontenergy.com)

We structure our response in three areas:

- License exemption limits and third party access;
- Distribution price controls;
- License simplification for distributed energy

### **1.1 License Exemptions**

Fontenergy is pleased that BERR/Ofgem have decided not to raise the exemption limits. However, we are concerned that BERR/Ofgem did not use this opportunity to amend the supply and distribution exemptions to be based on site rather than company limits. We believe the company limits are difficult to enforce in practice as parties will be able to find contractual work arounds to avoid the company limit for small sites. As such, we believe that the retention of this limit will simply add costs to the system, without achieving the desired objective.

We believe that a more pragmatic approach would be to amend the regulations to a site limits basis. We also believe that parties should seek approval to operate an exempt site, so that BERR/Ofgem have records of all exempt sites.

Since the Citiworks ruling, we have been working with Elexon to understand how an exempt site could offer third party access under the current market arrangements. We have identified two options, one physical and one financial, which work within the arrangements. The physical settlement uses the rules for meter volume reallocation at the boundary meter, whilst the financial settlement involves setting a reference price for financial settlement (similar to a contract for difference). We therefore believe that there is no technical reason not to amend the exemption rules to require third party access to the exempt network and its customers and would support any such amendment.

### **1.2 Distribution Price Controls**

We are pleased to see that Ofgem is supporting and progressing changes to the distribution pricing to reflect the actual costs of distributed generation on distribution networks. One of the key incentives for exempt sites are the high distribution costs on public wires. The licensed distribution company costs reflect the total costs associated with distributing power from the transmission network to the end customer. For distributed energy sites,

most of the energy is generated and consumed within a small geographical area and is not transported on the wider distribution (let alone transmission) network.

As we understand it, the work so far focuses on changes to distributed generation tariff charges and distribution losses. We believe that this only partially reflects the benefits seen by an exempt site. We would strongly encourage Ofgem to consider changes to the customer tariffs to implement a short-haul distribution tariff for energy that is generated and consumed locally - thereby avoiding most of the wider distribution infrastructure. Furthermore, we have major concerns over the viability of a significant proportion of distributed energy developments unless such a change is made - particularly if there is a shift away from private wire to a simplified licence based paradigm.

### **1.3 Simplified License Arrangements**

Fontenergy strongly supports the proposals for simplified license arrangements, where parties are able to subcontract the need to comply with industry codes to a third party and have the license conditions associated with the industry codes "switched off". We believe this is the only plausible option to enable distributed energy sites to become part of the wider industry arrangements.

As these arrangements ensure the full requirements of the industry codes are met (albeit through a third party), we believe there should be no restrictions put in place regarding the size or location of the licensed "light" party. We believe the costs of the Supplier Services Agreements (SSA's) will encourage license light parties to become fully licensed once they reach sufficient scale.

We are, however, concerned with the costs of contracting for an SSA agreement both from the point of view of a company that might wish to contract for an SSA or offer an SSA. We estimate that the legal costs alone, excluding any internal staffing costs, will amount to several hundred thousand pounds. We would welcome a collaborative approach with BERR/Ofgem to set standard contractual arrangements. We would like to be involved in any discussions and workshops on this issue.

We also believe there will be a considerable amount of work to change the codes and integrate systems to allow the fully licensed party and the licensed light party to work together. This will be important to allow the smooth transfer of customers and maintain the integrity of the arrangements. In particular, we would support changes to the arrangements to recognise the legal rights of the license light party to its customers. We are happy to work with Ofgem and BERR on these issues.

Finally, we believe that the shift to a simplified licence structure should be accompanied by changes to the distribution charging structure - i.e. putting in place a short-haul tariff that better matches distribution prices to true cost (see comments in 1.2 above). Without such a change we envisage that there will be resistance from ESCO providers (and developers) to the new regime, as they will have both: (a) increased costs associated with operating within the new licence regime; and (b) an increase in distribution costs (as cf. private wires).