

Distributed Energy - Final Proposals and Statutory Notice for Electricity Supply Licence Modification

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Target Audience: Owners and operators of distributed energy schemes, electricity suppliers, distribution network operators, consumer groups, local authorities, property developers, and manufacturers and any other interested parties.

Overview:

Ofgem is committed to doing what it can to address climate change and facilitate sustainable development in the gas and electricity sectors. Over the past two years, we have worked with Government, distributed energy (DE) developers, licensed suppliers and other stakeholders to identify options to reduce the regulatory barriers to the development of DE. We are proposing to introduce additional licensing options to make it easier for small energy companies including DE schemes to operate as a licensed supplier in the community on the public network. The proposals will allow small suppliers to become licensed suppliers in a way that is proportionate to their size and impact, while protecting consumers' rights to switch energy supplier.

This document sets out our final proposals and a statutory consultation notice to implement a new standard licence condition. It also includes draft guidance on how the regime would work and the Authority's approach to considering applications from licensees. We also invite expressions of interest from stakeholders to participate in a working group to develop good practice for the provision of third party service arrangements, as well as consider and take forward consequential changes needed to support the new commercial arrangements.

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Context

A low carbon energy sector, security of supply and alleviating fuel poverty are priorities for achieving sustainable development. Distributed energy (DE) could make an important contribution to all these goals. This project is an important part of Ofgem's work with Government and industry to remove barriers and create a framework for innovative and effective ways of delivering a more sustainable energy system.

The issues facing DE are wide-ranging and touch on many aspects of energy and environmental policy and regulation. Consequently, this work stream sits alongside other specific work underway across Ofgem and Government that will have a significant influence on the future development of DE, including:

- Commitment by Government in the Energy Act 2008 to establish incentives for renewable heat and for small-scale renewable power generation;
- the EU Renewable Energy Directive that sets a target for the UK that 15 per cent of energy consumption should be met from renewable sources by 2020;
- the forthcoming UK Renewable Energy Strategy setting out how the UK will achieve its share of the EU renewable energy target;
- the Government's consultation on the definition of zero carbon homes and non-domestic buildings;
- the Government's forthcoming consultation on a Heat and Energy Savings Strategy;
- Ofgem's review of Industry Code Governance;
- Ofgem's fifth electricity Distribution Pricing Control Review; and
- Ofgem's consultation on electricity network charging regime.

Associated Documents

- Distributed energy - Further proposals for more flexible market and licensing arrangements, June 2008
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=4&refer=Sustainability/Environment/Policy/SmallGens/DistEng>
- Distributed energy - Initial proposals for more flexible market and licensing arrangements, December 2007
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=2&refer=Sustainability/Environment/Policy/SmallGens/DistEng>
- Review of distributed generation: A joint Government/Ofgem Report, May 2007
<http://www.berr.gov.uk/whatwedo/energy/whitepaper/consultations/distributed-generation/page39557.html>
- Energy White Paper: meeting the energy challenge, May 2007
<http://www.berr.gov.uk/whatwedo/energy/whitepaper/page39534.html>

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Summary

An important objective of our work is to ensure that the regulatory regime protects consumers, ensures the effective operation of the market and at the same time supports innovative and effective ways of delivering a more sustainable energy system. This document sets out our final proposals to make it easier for distributed energy (DE) developments to operate as a licensed supplier on the public network.¹

Government, at central and local level, has recognised the potential for DE in decarbonising the built environment. Accordingly, initiatives have been put in place such as moves towards zero carbon development and the Planning Policy Statement on Climate Change for local planning authorities to set targets for use of low carbon and renewable energy in new developments. The Government has also recently committed in the Energy Act 2008 to establish incentives for renewable heat and for small-scale power generation. Together, these initiatives are likely to encourage the development of DE, with some schemes required or wanting to supply power to local domestic customers.

Over the past two years we have worked with distributed energy developers, energy suppliers and other stakeholders to identify options to reduce the market and regulatory barriers to the development of distributed energy. These proposals are the conclusion of work led by Ofgem in collaboration with BERR (whose energy policy activities have been transferred to DECC) and stakeholders through several working groups and two consultation documents.

We are proposing to modify one standard condition of the supply licence to make it easier for DE schemes and small suppliers to operate as a licensed supplier on the public network. The proposed modification will provide an option for a derogation from the requirement to be a direct party to the industry codes in the electricity supply licence condition 11.2 as long as alternative arrangements are in place with a third party licensed supplier that is a signatory to the industry codes for the scheme to operate in the competitive market and allow consumers to switch energy supplier. This option will reduce the costs, complexities and risks of becoming an independent, small-scale licensed supplier.

Energy companies, including DE schemes, above a certain size supplying electricity to domestic customers in Great Britain are required to obtain an electricity supply licence under the Electricity Act 1989.² Licence conditions oblige suppliers to comply with regulatory and industry requirements in order to facilitate wholesale market trading, real time system balancing, retail competition and consumer protections. The costs incurred from directly complying with the high competency aspects of the industry codes are not scaleable and for small-scale electricity suppliers³ add significant overheads.

1 Distributed energy is defined in this document as renewable electricity generation which is connected directly into the local distribution network, as opposed to connecting to the transmission network, as well as combined heat and power schemes of any scale.

2 The Electricity (Class Exemptions from the Requirement for a Licence) Order 2001 set an upper threshold for domestic supply at 2.5MW which roughly corresponds to 2,500 customers.

3 Small scale in this context is approximated by a domestic customer base of up to 10,000.

This licensing option is relevant to small-scale supply companies and DE schemes who intend to supply domestic customers but exceed the threshold in the Electricity (Class Exemptions from the Requirement for a Licence) Order 2001. It is a non-discriminatory option and therefore available to DE schemes and also other small suppliers that want to become licensed even if they do not source electricity from DE to supply their customers.

The effectiveness of this licence modification on the take up of DE and market entry of small suppliers will depend on the availability and competitiveness of appropriate services from third party licensed suppliers. We do not intend to require suppliers to offer these services. Instead, we will work with interested stakeholders to improve understanding of how the regime would work so that participants can begin to explore viable business models for providing these services competitively. We will monitor developments in the market and review the position in two years time to assess the market response.

Policy developments

We consulted on initial options for more flexible market and licensing arrangements in December 2007 and again in June 2008. This document reports on the responses to the questions we asked in June and sets out our decisions on the policy proposals to allow DE to grow within the competitive market. These include:

- a derogation from the licensing requirement to be a party to the industry codes, on condition that the DE scheme has appropriate alternative arrangements;
- encouraging the development and provision of services from a third party to enable DE schemes and small suppliers to operate on the public network;
- encouraging the participation of DE in the main industry codes; and
- the introduction of cost reflective network use of system charging to ensure economic development on public networks.

Next steps

We informally consulted on the proposal to modify the standard licence conditions to make it easier to become a licensed supplier in June 2008. This document sets out a statutory consultation notice as required under the Gas and Electricity Acts for a licence modification. The closing date for licensees' representations or objections to the proposals is 6 March 2009. Subject to the result of this process, we intend to introduce the new standard licence condition in March 2009.

We will work with interested stakeholders to encourage the development of competitive third party service arrangements. As a starting point we have included in this document draft guidance on how the regime would work. In early 2009 we will convene a working group to help participants explore viable business models for providing these services competitively, and good practice on the provision of alternative arrangements. We also expect the group to take forward new process and consequential changes to industry codes needed to support the new commercial arrangements. We invite expressions of interest from stakeholders to participate.

1. Introduction

Chapter Summary

This chapter briefly considers the context and objectives of the joint BERR (now DECC) and Ofgem project on distributed energy and describes the structure of this document.

1.1. Over the next decade and beyond the UK will need to transition to a lower carbon energy system while maintaining security of supply. This will involve a significant increase in the proportion of energy derived from renewable, nuclear, or other low carbon sources. Progress towards the Government's low carbon energy goals could be facilitated by the take up of DE technologies such as low and zero carbon small-scale generation and community CHP.

1.2. The objectives for this project were originally set in the Distributed Generation Review and the Energy White Paper published in May 2007. The overall objective was to develop proposals for more flexible market and licensing arrangements for distributed low carbon electricity within the licensed framework, to be implemented by the end of 2008.

1.3. Our proposals also meet our statutory duties to protect the interests of present and future customers by promoting competition and to regulate effectively and only where necessary whilst contributing to the achievement of sustainable development.⁴

Structure of this document

1.4. In chapter 2, we review the key policy developments that have led to our decisions on the final proposals. This includes a brief summary of the views of respondents to the questions raised in the June consultation.

1.5. Chapter 3 introduces the draft guidance set out in appendix 3. The draft guidance in appendix 3 describes how the licensing regime under the proposed licence modification is expected to work in practice and the procedures and criteria the Authority will take into account when considering applications from licensees to operate in this regime.

1.6. The statutory notice to modify the electricity supply licence and the final proposed legal text for the modification proposal are given in appendix 2.

⁴ The Energy Act 2008 modified the general duties of the Authority in carrying out its functions under the Gas Act and the Electricity Act. In particular, when carrying out its functions in the manner it considers is best calculated to further its principal objective, the Authority must do so by having regard to the need to contribute to the achievement of sustainable development equally with the need to secure that all reasonable demands for electricity and gas are met and that licensees are able to finance their regulated activities.

2. Final proposals - developments since June 2008

Chapter Summary

This chapter sets out our decisions following responses to the June 2008 consultation on policy proposals to:

- modify the standard electricity licence condition (SLC) 11 to provide a derogation from the requirement to being a direct party to the industry codes
- encourage the development and provision of supplier service arrangements from third parties
- increase the participation of distributed energy in the governance process for wholesale market trading arrangements
- accelerate the introduction of cost reflective charging for use of system on public networks

2.1. Our proposals are the culmination of a two-year collaboration with BERR (whose energy policy activities have subsequently been transferred to the Department of Energy and Climate Change) and stakeholders. During that time we have identified several issues and the key barriers to the greater uptake of DE within the market and licensing arrangements, and consulted on a range of options to address these.

Collective licence modification for flexible licensing options

2.2. In June we proposed to introduce an additional licensing option to make it easier for DE schemes to operate as a licensed electricity supplier on the public network. The licence obligation to become a direct party to the industry codes in SLC 11.2 involves significant investment in IT systems and expertise⁵. In particular, the costs relating to the implementation of the Balancing and Settlement Code and the Master Registration Agreement are largely fixed and for a small supplier or DE scheme represent a high transaction cost per unit of the output sold. The process is also difficult for those not familiar with all the complexities of the industry and how best to manage them. In addition a DE scheme, as a standalone supplier, is exposed to settlement penalties on its net energy balance. We argued these costs, complexities and risks are significantly disproportionate for an independent, small-scale licensed supplier compared to a large supplier with a mixed generation and customer portfolio.

2.3. We proposed a collective licence modification to allow the option of not being a direct party to the industry codes in standard electricity supply licence condition 11.2. Instead, the prospective licensee could request the Authority to give a direction permitting it not to be a direct party on condition alternative arrangements were in place with a licensed third party, who is party to the codes, to discharge the necessary code functions and activities on its behalf so that the scheme operates in the competitive market and customers can switch supplier.

⁵ SLC 11.2 requires licensed electricity suppliers to become a party to and comply with the Master Registration Agreement; the Distribution Connection and Use of System Agreement; the Connection and Use of System Code; and the Balancing and Settlement Code.

2.4. This licensing option is a non-discriminatory option and therefore available to DE schemes that want to supply on a community scale and also to other small suppliers that want to become licensed even if they do not source electricity from DE to supply their customers.

2.5. In their responses to the June consultation, all licensed suppliers supported the proposal in principle as a proportionate measure to tackle the costs and complexities of becoming a licensed supplier faced by smaller parties. They also agreed that it was preferable solution as it allowed for the growth of DE within the regulatory regime rather than encourage the development of DE outside the competitive market.

2.6. Licensed suppliers also indicated their support for the proposal was conditional on further information about the regime and/or the final wording of the draft amendment. Suppliers specifically wanted further guidance on how the regime would work in practice and the process the Authority would follow in granting a direction and ensure that alternative arrangements provided customers access to the competitive market and the protections of the licence framework.

2.7. Consumer groups were generally supportive of this proposal but noted some concern about whether consumers could suffer indirect impacts if the services on offer from a licensed third party were not competitively priced.

2.8. DE developers generally welcomed the proposed regulatory route to market. They recognised the flexible licensing option offered an opportunity for a local market in low and zero carbon electricity across a number of sites on the public network⁶. This could allow DE schemes to achieve more economic scales through operating larger energy centres to serve several developments and buildings in an area.

Ofgem's view

2.9. An important objective of our work is to ensure the regulatory regime supports innovative and effective ways of delivering a more sustainable energy system and at the same time ensures the effective operation of the market and protects consumers. We intend to increase the flexibility of licensing options and to make it easier to become a licensed supplier on the public network.

2.10. In our view the requirements of SLC 11.2 pose disproportionate costs for DE schemes and small suppliers, and can be substituted by robust alternative arrangements from licensed third parties for the scheme to operate in the competitive market.

2.11. We propose to modify the standard licence conditions to make it easier for DE schemes to operate as a licensed electricity supplier in the community on the public network. The modification will give prospective electricity suppliers the choice of not

⁶ The public network here refers to the licensed distribution network.

being a direct party to the industry codes in SLC 11.2. Instead, the Authority would be empowered to give a direction to a licensee permitting it to have arrangements in place with a licensed third party, who is party to the codes, to discharge the necessary code functions and activities on its behalf so that the scheme operates in the competitive market and customers can switch supplier.

2.12. The proposal will offer real benefits for stakeholders by making it easier for small participants to become a licensed supplier on the public network and offer competitive sustainable energy services to customers. It also ensures customers have access to the competitive market and can switch suppliers. In our view, competition remains an effective form of protection for consumers.

2.13. Formalising the proposal in a standard licence condition is consistent with the principles of better regulation - particularly in terms of proportionate, transparent and targeted regulation. This proposal will allow smaller participants to become licensed suppliers in a way that is proportionate to their size and impact. It will also be a more transparent process for those not familiar with the complexities of the licensing and regulatory arrangements.

2.14. The statutory notice for the electricity supply licence modification and the draft amendment is given in appendix 2. We received one substantive response on the proposed wording of the draft licence amendment we informally consulted on in June 2008. We have re-drafted the licence amendment in light of these comments.

2.15. We agree that guidance on the regime will be useful for all parties' understanding of the regime. In chapter 3 we give a high-level overview of the scope and purpose of the guidance. The draft guidance is set out in full in appendix 3 of this document.

Next steps

2.16. Supply licence holders may submit representations or objections by 6 March 2009 to the proposal set out in the notices made under section 11A of the Electricity Act. The Notice is set out in appendix 2.

2.17. If we receive objections from less than 20 percent of the relevant licence holders; or less than 20 percent of the relevant licence holders weighted according to their market share then we intend to implement the modification to the standard supply licence condition.

Encourage the development of third party service arrangements

2.18. A licensed supplier operating on the basis of the proposed amendment described above will need an arrangement with a licensed third party to undertake certain industry functions and activities prescribed by the industry codes. In June we

discussed how the success of this licensing option for the development of DE within the regulatory regime would depend on the availability and competitiveness of services. We sought stakeholders' feedback on whether it is preferable to let the market develop as demand from DE schemes and smaller suppliers comes forward or alternatively, require the larger licensed electricity suppliers to offer services.

2.19. Most stakeholders did not want to impose obligations on licensed third party suppliers to offer services, at least in the short term. There was some concern that introducing prescriptive requirements at this stage could have unintended consequences such as discouraging innovation or reducing the opportunity for niche market players to come forward.

2.20. Licensed suppliers emphasised the need for more information on the scope of the activities to be covered by the arrangements so they can begin to explore viable business models for offering these services competitively. Other stakeholders welcomed Ofgem's commitment to monitor market developments and review the position in two years time to ensure that the market is responding adequately.

2.21. Most stakeholders welcomed the establishment of an industry working group on supplier service agreements as a good first step. It was generally recognised that DE providers and licensed suppliers have limited experience to draw on. One stakeholder noted the possible high costs of contracting an agreement for these services. Therefore, a working group and collaborative approach could be very helpful in terms of developing a flexible framework and good practice for arranging agreements.

2.22. In June we highlighted that there could be some new processes or consequential changes to the industry codes to support the commercial arrangements. In particular, we asked stakeholders to consider the processes that might be necessary in the event that there was a breakdown in the provision of service arrangements as a result of the third party licensed supplier becoming insolvent. At a high level, stakeholders suggested that a working group should consider a process similar to a supplier of last resort.

Ofgem's view

2.23. The impact of this new licensing option on the take up of DE and development of local energy suppliers will depend on the availability and competitiveness of suitable services from licensed third party suppliers. We do not intend to require licensed electricity suppliers to offer these services. Introducing prescriptive regulations based on the assumption that suppliers do not have incentives to provide these services could have unintended consequences such as discouraging innovation or reducing the opportunity for niche market players to come forward.

2.24. We agree with the views of respondents that in the first instance it is preferable to see the development of service agreements coming from the market. We will work with interested stakeholders to encourage the development of competitive third party arrangements and good practice on the provision of these. As a starting point we are

providing more information in this document about how the regime would work. This will help licensed energy suppliers and other interested parties begin to explore viable business models for providing these services competitively.

2.25. We agree that a working group is also needed to implement some consequential changes in the industry codes and develop new processes to support the new commercial arrangements. One important example is the design of a specific process for managing the breakdown of third party service arrangements in the event of a third party supplier becoming insolvent. In such a case, a supplier of last resort (SOLR) might be appointed to take over all of the customers registered with the insolvent licensed third party supplier including the customers of the DE supplier. This would be a significant risk for any small supplier or DE scheme. However, this could be overcome by putting in place fairly simple arrangements, similar to SOLR. For example, Ofgem would seek bids from alternative licensed suppliers who provide service arrangements that are willing to step in and take over the provision of services. It is important that the process ensures that the affected small supplier or DE scheme are at no time left without satisfactory arrangements and therefore in breach of the conditions for the derogation in their supply licence. We understand that there is provision in the registration data of metering points to identify market participants distinct from the supplier that completed the registration. This would be useful for identifying the customers that 'belong' to the licensed DE supplier and could be used for in the process described above.

Next steps

2.26. We will work with interested stakeholders to encourage the development of competitive third party supplier services and ensure that the new commercial arrangements are recognised within the industry codes and processes. In early 2009 we will convene a stakeholder working group to take these forward. We invite expressions of interest from stakeholders to participate.

Participation of DE in governance processes for wholesale market trading arrangements

2.27. In June we discussed the risks and costs that a DE generator could be exposed to as a result of a particular aspect of the wholesale market trading arrangements known as the balancing mechanism. All parties participating in wholesale markets are exposed to cash out prices, which reflect the costs that the system operator incurs in balancing the system every half hour. The risk of being out of balance and exposure to cash out prices is high for single plant generators that cannot always guarantee output (i.e. renewable) and are subject to the possibility of technical failure. DE generators that sell output to a third party are also affected by imbalance risk.⁷

⁷ In June 2008 we quantified the indirect impact as the discount third parties price into offtake power purchase agreements to compensate for managing the imbalance exposure on behalf of DE generators. Please see the appendix 4 in:

2.28. The cash out rules sit within the Balancing and Settlement Code (BSC), and changes to the rules can only be proposed by signatories to the code. However, most DE schemes are not party to the BSC, consequently they do not have the power to propose code modifications to change the industry rules. In June 2008 we consulted on a proposal to designate a DE representative to raise modifications to the BSC.

2.29. Stakeholders' views on this proposal were mixed. Some licensed suppliers and other stakeholders supported the proposal in principle as a useful step, especially with the potential increase of DE in the UK energy mix. Conversely, some licensed suppliers and other stakeholders did not think the proposal was necessary because DE interests were sufficiently considered through the code modification process. One stakeholder disagreed with proposal in principle because they thought it only dealt with a symptom and did not address the more fundamental need to reform the objectives of industry codes in line with Ofgem's sustainability duty.

2.30. Another area of major contention was around funding. On the one hand, some respondents thought it was appropriate that the DE representative contribute fees to help meet Elexon's costs, while on the other hand, some respondents thought it was more appropriate to fund and resource DE participation.

2.31. After we published our proposals to designate a DE representative, the Authority published its decision on the scope of a review of industry code governance.⁸ Among other aspects, the review will consider initiatives to support smaller players' participation in the major industry codes. The Authority are concerned that the complexity and fragmentation of current arrangements is a barrier for smaller participants, including consumer representatives, and new entrants to engage with major industry code arrangements. They also noted that small participants have less resources and less capability to influence change when compared to the incumbent energy companies.

2.32. As part of the code governance review, Ofgem is currently consulting on options to increase the inclusiveness and accessibility of all code governance processes across the board of possible interests such as customer representatives and smaller energy market participants. In addition, it is considering funding options to resource small participants and new entrants to take part in industry arrangements⁹.

Ofgem's view

2.33. There is a clear overlap between the proposal we put forward in June 2008 and the small participant / consumer work strand in the code governance review. In our

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=4&refer=Sustainability/Environmnt/Policy/SmallrGens/DistEng>

⁸ In general terms, the scope of the code governance review is looking at reducing the complexity of industry code governance arrangements. For more information please see:

<http://www.ofgem.gov.uk/Licensing/IndCodes/CGR/Pages/GCR.aspx>

⁹ Please see Chapter 6 in

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=82&refer=Licensing/IndCodes/CGR>

view the latter supersedes the original proposal put forward for DE in the June 2008 consultation. The governance review has a broad remit to reduce the complexity of the industry codes, introduce arrangements to engage smaller participants and consumers, and also overcome resourcing constraints. We think the issues DE face that stem from the industry governance process will be better addressed through this integrated approach. Accordingly, we will not proceed with the specific proposal in the June consultation to designate a DE representative to the BSC.

Cost-reflective charging for use of system on public networks

2.34. In the course of our work on facilitating DE, we have highlighted concerns that the current charging regime for using the distribution network did not properly reflect the benefits that DE can bring. Ofgem consulted on the structure of use of system charges in April and July 2008 to address these concerns and to align charging methodologies with the objectives of the fifth Distribution Price Control.¹⁰ In October 2008, Ofgem held a statutory consultation on a collective licence modification proposal to require distribution network owners (DNOs) to implement a common cost-reflective distribution charging methodology and governance arrangements by 1 April 2010. Unfortunately, the licence modification proposal was opposed and we failed to reach the legal threshold to implement the proposal.

2.35. Improving the structure of use of system charges remains a priority for Ofgem. A common and cost reflective charging regime would help to tackle climate change by attracting more distributed generation and encouraging more demand side management. It will also offer benefits to suppliers and customers and provide a more open and transparent set of governance arrangements.

2.36. We have recently consulted DNOs and other industry parties on the best way to progress this matter^{11,12}. We identified several options. These include: consulting on a revised licence condition to implement a common charging regime for lower voltage levels only; allowing DNOs to choose from two alternatives at extra high voltage level; or refer the whole matter for a ruling by the Competition Commission (CC).

Next steps

2.37. Ofgem will shortly decide whether to refer this matter to the Competition Commission having considered stakeholders' responses to the consultation on how best to progress this project.

10 Please see: www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgs

11 The December 2008 consultation document can be found here: <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=452&refer=Networks/ElecDist/Policy/DistChrgs>

12 Consultation closed on 22 January 2008.

The Class Exemption regime and 'Citiworks'

2.38. Licences are required for the generation, distribution, or supply of electricity. In the UK there are some circumstances where exemptions from the requirement to hold a licence are permitted by the Secretary of State for certain classes of scheme. These are set out in secondary legislation, in the Electricity (Class Exemptions from the Requirement for a Licence) Order 2001 (the "Class Exemption Order"). Exemptions are permitted in circumstances related to the levels of generation, supply and distribution and relationship between exempt parties and other licensed entities. Some classes of exemption relate to onsite generation, or generation that is connected to consumers by private wire; it is from these that we take the definition of private wire¹³.

2.39. Many of the conditions required in order to hold a licence are not imposed on exempt operators. This currently includes the need to allow third party suppliers to market and supply electricity to consumers on the private wire distribution network. Exempt distributors are therefore effectively able to run monopoly systems.

Citiworks judgment

2.40. In May 2008, the European Court of Justice delivered a judgment on a case known as 'Citiworks', which was concerned with the rights of suppliers to access customers on local distribution systems run as private wires. The judgment noted that a fully open market must allow all consumers to freely choose their suppliers and all suppliers freely to deliver to their customers. To allow for this, suppliers should have the right to access all the different distribution systems that carry electricity to customers.

DECC's view

2.41. Essentially the Citiworks judgment means that distribution network operators including those that are currently licence exempt will generally have to allow third party access to customers within their system.

2.42. DECC does not intend to go further than the judgement and require all exempt operators to become licensed. The exemptions regime was put in place to minimise the burden of regulation on schemes within this very limited scale of generation, distribution and supply and Government believes it still has a role to play. However, Government has made clear that the future development of the DE should not be dependent on exemptions. As set out in this document, DECC has been working with Ofgem to allow larger DE schemes to operate within the licensed framework on a cost-proportionate basis with support from third parties for the high-cost, high competency aspects participating in the electricity market.

¹³ The term 'private wire' is often used as shorthand for a direct and exclusive connection between a consumer and a generating station that is not on the same site. The term has specific connotations in the context of the electricity system, being associated with small distribution networks and exemptions from the need to hold electricity licenses.

Next steps

2.43. DECC intends to consult in spring 2009 on the practical implications of 'Citiworks' and on the potential amendments to the Class Exemption regime that may be necessary in order to take account of this judgment.

3. Supplementary document

Chapter Summary

This chapter introduces the draft guidance we have prepared to assist all parties' understanding of the regime implemented by the proposed electricity supply licence modification. The draft guidance is set out in appendix 3.

Draft Guidance on the regime

3.1. In June 2008 we asked for views on whether it would be helpful for Ofgem to provide guidance to assist parties' understanding of how the regime would operate under the proposed licence modification. All stakeholders welcomed additional information in the form of guidance. Some of the reasons for this were:

- Suppliers need more information to consider whether or not to accept the licence modification proposal.
- Suppliers wanted more information on how the regime would operate to ensure the integrity of the competitive market would not be compromised.
- Guidance would help licensed suppliers and other interested parties to explore viable business models for providing the third party services.
- Prospective licensees that are planning developments would benefit from greater regulatory transparency and consistency.
- Guidance would help small suppliers understand their licensing obligations and the purpose and content of a services arrangement with a licensed third party.

3.2. We held a stakeholder meeting in September 2008 to scope out and develop the basis for the guidance on the regime. We are grateful to those that participated and their contribution has informed the draft guidance in appendix 3, covering:

- the procedures and criteria the Authority would have regard to when considering an application for direction in accordance with the proposed licence modification, SLC 11.3;
- how the regime would work in practice including the roles and responsibilities of all parties and the code activities and functions covered by the arrangements;
- compliance and enforcement issues including circumstances leading to the revocation of the licence; and
- the status of the guidance.

3.3. We welcome feedback on the draft guidance in appendix 3. We will issue revised guidance, subject to stakeholder feedback, if and when the proposed collective licence modification for SLC 11.3 is implemented. From time to time, the guidance may be updated to ensure it reflects industry processes and practice.

Appendices

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Appendix 1 - List of respondents to June 2008 consultation

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1	EDF Energy
2	RWE npower
3	Good Energy
4	Future Energy Yorkshire
5	Electricity North West Ltd
6	energywatch
7	Centrica plc
8	SembCorp
9	Scottish and Southern Energy
10	London Climate Change Agency
11	Elexon
12	E-on UK
13	Arup
14	SP Energy Networks
15	fontenergy
16	Combined Heat and Power Association
17	CE Electric UK
18	Cornwall Energy Associates
19	ScottishPower

Responses received by Ofgem which were not marked as being confidential have been published on Ofgem's website www.ofgem.gov.uk.

Appendix 2 – Notice of proposed modification to electricity supply licence standard conditions

1.1. The appendix sets out the notice of modification to the standard conditions of the Electricity Supply Licence under section 11A of the Electricity Act 1989.

**COLLECTIVE LICENCE MODIFICATION PROPOSAL
(introducing flexible licensing options for small suppliers)**

**NOTICE CONCERNING THE PROPOSED MODIFICATION OF THE STANDARD
LICENCE CONDITIONS OF ELECTRICITY SUPPLY LICENCES UNDER
SECTION 11A(3) OF THE ELECTRICITY ACT 1989**

The Gas and Electricity Markets Authority ("the Authority") hereby gives notice pursuant to section 11A(3) of the Electricity Act ("the Act") as follows:

1. The Authority proposes to modify all electricity supply licences granted or treated as granted under section 6(1)(d) of the Act by amending Standard Licence Condition (SLC) 11.
2. The primary reason why the Authority proposes to make this licence modification is to implement its decision, by way of a power for the Authority to grant a direction to supply licensees, to introduce flexible licensing options for operating as a licensed supplier on the public network. This is consistent with the Authority's decision published on 6 February 2009 titled "Distributed Energy: Final Proposals and Statutory Notice on Electricity Supply Licence Modification" (08/09). The proposed licence modification is attached at Schedule 1 to the Notice and modifies SLC 11.
3. The proposed modification to SLC 11 allows for the Authority to grant a direction relieving supply licensees from the obligations in SLC 11.2 (in whole or in part) on condition the Authority is satisfied that adequate arrangements are in place in lieu of direct compliance. This power is provided for by the addition of three new paragraphs directly after SLC 11.2 setting out the 'Power to issue direction to relieve industry code obligations'. In particular, SLC 11.3 provides the Authority a power to issue a direction. SLC 11.4 allows the Authority to issue guidance which it will have regard to when considering using its power to issue a direction. SLC 11.5 sets out the purpose, scope and general content that such guidance might contain. There is also a consequential change to re-number the remaining paragraphs in SLC 11 that follow directly after SLC 11.5.
4. The effect of the proposed modification is to allow smaller participants to become licensed suppliers in a way that is proportionate to their size and impact. It will also be a more transparent process for those not familiar with the licensing arrangements. More detailed reasoning for the proposed licence modification has been published by the Authority, namely:
 - (a) a decision document entitled "Distributed energy - Final Proposals and Statutory Notice on Electricity Supply Licence Modification" (08/09) on 6 February 2009
 - (b) a consultation entitled "Distributed energy - further proposals for more flexible market and licensing arrangements" (87/08) on 18 June 2008
 - (c) a consultation entitled "Distributed energy - initial proposals for more flexible market and licensing arrangements" (295/08) on 18 December 2007.
5. Relevant licence holders for the purposes of this Notice are all holders of the Electricity Supply Licence (Standard Conditions) at the relevant time with Standard Condition 11 in force.
6. A pro forma that relevant licence holders may wish to use in order to register a statutory objection is appended to this notice.

7. A copy of the proposed modification and other documents referred to in this notice are available (free of charge) from the Ofgem Library (telephone 020 7901 7000) or the Ofgem website (www.ofgem.gov.uk).

8. Any representations or objections to the proposed licence modification may be made on or before 6 March 2009 to: Anna Kulhavy, Office of Gas and Electricity Markets, 9 Millbank, London, SW1P 3GE or by email to anna.kulhavy@ofgem.gov.uk.

9. All responses will normally be published on Ofgem's website and held in the Research and Information Centre. However, if respondents do not wish their response (or any part of it) to be made public then they should clearly mark their response (or relevant part of it) as not for publication. Ofgem prefers to receive responses in an electronic form so they can be placed easily on the Ofgem website.

.....
Martin Crouch, Director of European Strategy and Environment
Duly authorised on behalf of the
Gas and Electricity Markets Authority
06 February 2009

Schedule 1**Condition 11. Compliance with codes**

Insert section heading and three new paragraphs after paragraph 11.2, as follows:

Power to issue direction to relieve certain industry code obligations

11.3 The Authority, after consulting with the licensee and any other person or body likely to be affected and after having regard to any guidance issued in accordance with paragraph 11.4, may give a direction to the licensee relieving it of its obligations (in whole or in part) under paragraph 11.2.

11.4 The Authority may issue, and may from time to time revise, guidance regarding the manner in which it will exercise its powers under paragraph 11.3.

11.5 The guidance issued in accordance with paragraph 11.4 may, in particular, set out:

- (a) the process for requesting the Authority to grant a direction under SLC 11.3;
- (b) the type of information that is likely to be required by the Authority as part of that process; and
- (c) the criteria the Authority would have regard to in considering whether and to what extent to exercise its power to give a direction under paragraph 11.3;

There is also a consequential change to SLC 11, specifically re-numbering the remaining paragraphs, as follows:

Consequential changes

11.5 If a Consequential Change is required, the licensee must take all reasonable steps to secure, and must not take any unreasonable steps to prevent or delay, the making or implementation of that Consequential Change.

11.6 Paragraph 11.5 is without prejudice to:

- (a) any rights of appeal that the licensee may have in relation to decisions made by the Authority under the Industry Codes; and
- (b) any rights of approval, veto, or direction that the Authority or Secretary of State may have in relation to changes to the Industry Codes.

Fuel Security Code

11.7 The licensee must comply with the Fuel Security Code.

11.8 The Fuel Security Code has effect as a standard condition of this licence.

Appendix 3 – Draft Guidance on the licence regime to operate under Electricity Supply Licence Condition 11.3

Introduction

1.1. This draft guidance provides information on the licence regime that would be implemented by the proposed collective licence modification set out in the statutory consultation notice in appendix 2. Under the proposed licence modification, Electricity Supply Licence Condition 11.3 (SLC 11.3), the Authority could grant a direction permitting prospective licensees not to become a direct party to the industry codes set out in SLC 11.2 on condition alternative arrangements are in place with a third party licensed electricity supplier, who is party to the relevant industry codes, to discharge the necessary industry functions and activities on behalf of the licensee on an ongoing basis¹⁴.

1.2. This licensing option is relevant to small-scale supply companies and DE operators who intend to supply electricity to domestic customers but exceed the threshold in the Electricity (Class Exemptions from the Requirement for a Licence) Order 2001¹⁵. It is a non-discriminatory option and therefore would be available to DE schemes and also other electricity suppliers that want to become licensed even if they do not source electricity from DE sources to supply their customers.^{16,17}

1.3. This guidance provides a high-level overview of the application process to request the Authority to grant a direction under SLC 11.3 and the procedures and the criteria the Authority will have regard to when it is considering such requests. It also gives more information on how the regime is likely to work in practice. It is not a guide to applying for an electricity supply licence in general. Applicants wanting to operate as a licensed electricity supplier with a direction under SLC 11.3 should read this document in conjunction with the document titled "Gas and electricity licence applications – Guidance 1 October 2008"¹⁸. They should also refer to the Application Regulations¹⁹.

1.4. The guidance provided in this document is intended to assist all parties' understanding of the regime so that:

- current licence holders can make an informed decision about the proposed collective licence modification SLC 11.3;
- larger suppliers and other interested parties can begin to explore viable business models for offering third party supplier services;
- prospective licensees can plan developments with greater regulatory transparency and consistency; and
- parties can ensure they have in place satisfactory arrangements to meet their responsibilities in accordance with the requirements of SLC 11.3.

¹⁴ SLC 11.2 requires licensed electricity suppliers to become a party to and comply with the Master Registration Agreement; the Distribution Connection and Use of System Agreement; the Connection and Use of System Code; and the Balancing and Settlement Code.

¹⁵ http://www.opsi.gov.uk/si/si2001/uksi_20013270_en.pdf

¹⁶ Distributed energy is defined in our work as renewable electricity generation which is connected directly into the local distribution network, as opposed to connecting to the transmission network, as well as combined heat and power schemes of any scale.

¹⁷ DE schemes refer to DE developers and operators who intend to supply domestic customers.

¹⁸ <http://www.ofgem.gov.uk/Licensing/Work/Documents1/LicAppGuidance011008.pdf>

¹⁹ The Electricity (Application for Licences and Extensions and Restrictions of Licences) Regulations 2008.

1.5. We welcome feedback on this draft guidance. We will issue revised guidance, subject to stakeholder feedback, if and when the proposed collective licence modification for SLC 11.3 is implemented. From time to time the guidance may be updated to ensure it reflects industry processes and practice.

Structure of this guidance document

1.6. Part 1 of the guidance summarises some of the main industry functions and activities that will need to be covered by alternative arrangements to allow an electricity supplier to operate in the competitive market without being a direct party to some of the industry codes. It also describes the roles and responsibilities of the various parties involved in such arrangements.

1.7. Part 2 of the guidance describes the general procedures and the criteria the Authority will have regard to when it considers applications for a direction in accordance with SLC 11.3.

1.8. Part 3 outlines compliance and enforcement issues and the circumstances that could lead to the revocation of a supplier's licence issued with a direction under SLC 11.3.

Part 1

1.9. This section summarises the functional activities that will need to be undertaken by a third party electricity supplier to allow a licensed supplier to operate in the competitive electricity market without being a direct party to the industry codes in SLC 11.2. These functional activities are fundamental to the effective operation of the electricity market and also to enable customer choice of electricity supplier. They arise from industry procedures that market participants need to comply with in the implementation of industry codes and arrangements, predominantly arising from the Balancing and Settlement Code (BSC) and the Master Registration Agreement (MRA).²⁰

1.10. Licensed electricity suppliers and DE schemes with a direction from the Authority under the proposed licence modification SLC 11.3 will not be a party to the industry codes in SLC 11.3 and therefore will not have qualified to undertake these activities directly themselves. Instead they will need to have in place alternative arrangements with a third party licensed electricity supplier that has passed the entry requirements of the relevant codes and is a party to the codes to undertake the necessary activities on their behalf.

1.11. A small supplier or DE scheme under this regime, would contract with a third party licensed supplier to arrange for the conveyance of electricity through the public network from entry point, or from the DE's generator, to its customers. In effect, the third party licensed supplier would act as a 'shipper' for the small-scale supplier or DE scheme. In this role, the third party licensed supplier would be the responsible party for the electricity while it is on route from the generator to the customer and would arrange for use of system from the Distribution Network Operator and manage the installation and administration of metering points registered on behalf of the small supplier or DE scheme. The third party supplier would be the visible party in the central settlement arrangements for the electricity while it is between the entry point and the exit meter points. The small supplier or DE scheme would have title to the electricity at the ends of the chain and 'own' the customer. The third party licensed supplier would also manage the change of supplier process on behalf of the DE scheme or small supplier.

1.12. The following table summarises some of the relevant industry arrangements and activities that a third party supplier would undertake while acting as a shipper described above. The third party supplier, as a Party to the Codes, is bound by its obligations to the Codes to undertake industry activities in a manner consistent with agreed industry procedures even when acting on behalf of the DE scheme or small supplier.

²⁰ The BSC governs the arrangements for the balancing mechanism and the Settlement of balancing mechanism transactions and imbalances. The MRA sets out the inter-operational arrangements that support the processes for the registration of a change of electricity supplier in the retail market.

Activity	Scenario	Responsibilities
<p>Arranging a network connection</p>	<p>A developer is building a DE scheme to supply electricity to domestic customers in a local development. The DE scheme has requested the Distribution Network Operator (DNO) for a connection of entry (generation) and, if it is supplying a new development, exit (supply) points. Alternatively, the DE scheme can instruct a third party Supplier to request the connections from the DNO on their behalf.</p> <p>The DE scheme makes their application on standard forms provided by the DNO. The DNO will provide guidance in cases where the standard forms are not appropriate and full details are required.</p> <p>DNO will discuss application and consider various aspects with the DE scheme to determine the offer of terms to enter into an agreement with the applicant for establishment of the proposed connection to and/or use of the DNO's Distribution System.</p> <p>Under the Competition in Connections policy applicants for new or modified connections may wish to take responsibility for some aspects of the associated work. The DNO will provide details of the scope and implications of contestable work on request.</p>	<p><u>All users</u> of the distribution network have a duty under the Distribution Code to provide information and resources as necessary to facilitate compliance with and implementation of the Distribution Code. A DE scheme will need to comply with technical requirements for connection set out in the section titled Distribution Planning and Connection Code.</p> <p>Standard condition 4D of the Distribution puts an obligation on the DNO to offer terms upon request for a connection to any size generator wanting to connect to the local network. These terms have to include details regarding works required to connect, reinforcement if necessary, metering requirements etc.</p>
<p>Registration of meters</p>	<p>The DE scheme or third party supplier receives notification that a new Metering Point has been established (depending on who requested the connection). The DE scheme requests the third party supplier to register the new metering point. The third party supplier registers the metering point with the MRA and receives confirmation of the registration from the Registration Service.</p> <p>Potentially the third supplier could register the meter point with</p>	<p>The licensed supplier with a direction under SLC 11.3 has a licence obligation to ensure it has alternative arrangements in place that enable customers to be part of the competitive market. An important industry process for this is the assignment of a unique identification for any point of access to the transmission system or any distribution system known as a Metering</p>

Activity	Scenario	Responsibilities
	a unique Market Participant ID for the DE scheme as part of the data items.	<p>Point Administration Number.</p> <p>Only licensed suppliers that are Parties to the BSC and MRA can execute the industry procedures to register a metering system in the metering system registration service.</p>
Meter installation and energisation	The DE scheme asks third party supplier to install meters and notifies the supplier of the agreed supply start date. The Supplier installs or appoints a Meter Operator to install metering equipment. The Meter Operator confirms the installation of meters has been completed and that energisation took place on the agreed date. The Meter Operator also provides meter details to the third party supplier.	<p>The licensed supplier with a direction under SLC 11.3 has a licence obligation to have in place arrangements that ensure the installation of approved metering systems in accordance with industry procedures.</p> <p>Only Parties to the BSC and MRA can execute the industry procedures to appoint licensed meter asset providers and operators for the installation of approved meters.</p>
Meter administration including data collection and data processing.	The DE scheme contracts the third party licensed supplier to manage the administration of its meter points on its behalf. The third party supplier appoints agents for data collection and data aggregation. The third party supplier exchanges details of the customers and agents between its agents and updates the Registration Service with agent details.	<p>The licensed supplier with a SLC 11.3 direction will have a licence obligation to have alternative arrangements to ensure the administration of its metering systems in accordance with industry procedures.</p> <p>Only Parties to the BSC and MRA can execute the industry procedures to appoint data aggregators to fulfil its settlement obligations for the metering systems it has registered on behalf of the smaller licensed supplier.</p>
Arranging a use of system agreement	The DE scheme wants to use the local network to supply its customers.	The licensed supplier with a SLC 11.3 direction will need to comply with operating procedures and provide the information

Activity	Scenario	Responsibilities
	<p>The DE scheme requests the third party licensed supplier to arrange a Use of System agreement with DNO to convey electricity through its Distribution System, to each Exit Point and from each Entry Point registered on behalf of the small supplier or DE scheme.</p> <p>The third party supplier arranges use of system agreement with DNO. The third party supplier requires the DE Scheme to procure agreements on the National Terms of Connection as part of their supply contract with customers.</p>	<p>necessary to allow the DNO to operate the System. These are set out in the sections titled Distribution Operating Code and Distribution Data Registration Code in the Distribution Code.</p> <p>In accordance with Clause 17 of the DCUSA the third party licensed supplier shall ensure that the DE scheme obtains agreements on the National Terms of Connection as part of their supply contract with customers. The third party licensed supplier shall ensure that such wording is presented in such a way as to create an effective contract (insofar as one can be created by presentation alone) between the DNO and the relevant Customer or Generator on the terms and conditions of the National Terms of Connection.</p>
<p>Supplier transfer process as new supplier</p>	<p>The DE scheme advises the third party licensed supplier that it has acquired a new customer and provides details of customers' premises at which a metering point is located.</p> <p>The third party licensed supplier registers this Change of Supplier and receives confirmation of the details of the old supplier's registration from the Registration Service. The third party supplier appoints the meter agents to the metering point</p>	<p>The licensed supplier with a direction under SLC 11.3 has a licence obligation to have in place arrangements to facilitate the customer choice of supplier.</p> <p>Only licensed suppliers that are Parties to the BSC and MRA can execute the industry process to undertake the change of supplier</p>

Activity	Scenario	Responsibilities
	<p>which is confirmed by the mutual exchange of agents' and customer details.</p> <p>On the supply start date the DE scheme contacts the Customer who provides a meter reading, this is sent to the data collector. The data collector validates the data and notifies the third party supplier that it has been accepted as the change of supplier meter reading.</p>	<p>process.</p>
<p>Supplier transfer process as old supplier</p>	<p>The third party licensed supplier is notified of the termination of its registration of a metering point it has on behalf of a DE scheme. The third party notifies the DE scheme and checks there is no objection to the change of supplier registration. Having confirmed that there is no objection the third party licensed supplier terminates the appointment of its agents to the Metering Point. On the supply start date the third party supplier receives notification of the change of supplier meter reading and informs the DE scheme.</p> <p>The DE scheme accepts this reading and uses it as a basis for their final bill. When the Customer settles the bill the DE scheme closes the customer account according to their business practice.</p>	<p>The licensed supplier with a direction under SLC 11.3 has a licence obligation to ensure that it has in place arrangements to facilitate the customer choice of supplier.</p> <p>Only licensed suppliers that are Parties to the BSC and MRA can execute the industry process to undertake the change of supplier process.</p>

Part 2

1.13. This chapter provides a high-level overview of the application process to request the Authority to grant a direction under SLC 11.3 and the procedures and criteria the Authority will have regard to when it is assessing requests.

Eligibility

1.14. Prospective electricity supply licensees and existing electricity supply licensees are eligible to apply to the Authority for a direction under SLC 11.3.

Manner of application

1.15. An application shall be made in writing, either by prepaid post or by electronic mail.

Information required

1.16. It is important to ensure that a licensed electricity supplier not being a direct party to the industry codes does not compromise the integrity of the market or impede consumer choice to switch electricity suppliers. Therefore, applicants must as part of their application for a direction under SLC 11.3 include sufficient information to enable the Authority to make a decision.

1.17. The request should include as a minimum:

- Details of the applicant, including full name and address of the applicant's premises.
- A clear description of specific industry codes in SLC 11.2 the applicant is requesting relief from in their application for a direction under SLC 11.3.
- A summary of the prospective licensee's business plan, including the number and type of any generation units that will be used to supply electricity, expected or target customer numbers, and customer type.
- Summary of proposed arrangements for ensuring security of supply for all consumers, including top up and back up arrangements and maintenance schedule of generation units.
- Name of the proposed third party licensed supplier(s) to provide services, including their Supplier Identification
- Particulars of applicant's proposed arrangements with a third party licensed supplier for the provision of industry compliant services, including:
 - Meter administration
 - Data collection and processing
 - Change of supplier process
 - Settlement of use of system charges
- The proposed duration of the direction under SLC 11.3.

1.18. The Authority may wish to discuss the arrangements with the named third party supplier and to review a copy of the executed contract prior to issuing the direction. However, it is not necessary to have completed the contract before making the application.

Ofgem's assessment

1.19. An application for a direction under SLC 11.3 will be assessed by Ofgem individually on its merits. In its assessment the Authority, having regard to its

principal objective and its statutory duties, including our duties in respect of sustainable development, will consider amongst other things the impact of issuing a direction under SLC 11.3 on consumers, competition, the ability of other authorised electricity operators to comply with their statutory obligations and licence conditions and sustainable development.

1.20. Ofgem is likely to consider the applicant has met the requirements and criteria for a direction under SLC 11.3 if the applicant has presented a realistic implementation plan for robust alternative arrangements with a third party licensed supplier to provide industry compliant services. We will consider whether the proposed arrangements demonstrate that:

- There are NO significant risks associated with operating under the proposed alternative arrangements to the licensee, other relevant licensees or customers.
- There are NO outstanding objections from other parties who are materially affected by the prospective licensee operating with a directive under SLC 11.3.
- The third party licensed supplier has the capability to provide satisfactory services.

Procedure

1.21. In order to assess applications more efficiently, we will not start to assess an application unless all the information required by these guidelines. In cases where insufficient information has been provided we will explain what more is needed.

1.22. Where further information or clarification is required we will consult with the applicant and agree timescales with individual applicants. Failure to meet these agreed timescales may lead to a refusal to grant a direction (although the applicant would be able to appeal against such a decision)²¹.

Consultation with other parties

1.23. As part of its consideration of the application for a direction under SLC 11.3, the Authority will consult with other parties as required. This could include a broader industry consultation, or directly affected parties such as the proposed third party supplier, and the licensee. Any consultation with the broader industry and authorised electricity operators will be at least 28 days.

Application of SLC 11.3 conditions

1.24. If Ofgem is satisfied the information received from the applicant meets the requirements and criteria for a direction under SLC 11.3 then the Authority will issue a direction. The Authority may wish to review a copy of the executed contract for the provision of alternative arrangements with a third party electricity supplier prior to issuing the direction. The direction will stipulate the codes the applicant will be relieved from and the time period specified in the direction and the date on and from which it will take effect. The direction may also contain such conditions as the Authority considers necessary or appropriate. A copy will also be placed on Ofgem's public register.

²¹ See Chapter 6 of the document titled "Gas and electricity licence applications – Guidance" <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=138&refer=LICENSING/WORK>

Part 3

1.25. This chapter outlines compliance and enforcement issues and the circumstances that could lead to the revocation of a supplier's licence issued with a direction under SLC 11.3.

Compliance with conditions set out in SLC 11.3

1.26. It is intended that the licensee with a direction under SLC 11.3 would be the principal party in terms of meeting their licence conditions. Therefore the onus will be on the licensee to comply with the conditions of SLC 11.3. Compliance will entail having suitable arrangements in place on an ongoing basis with a third party licensed electricity supplier that has met the entry requirements and is a Party to the relevant Codes. In this context suitable arrangements are taken to mean those that satisfy Ofgem's assessment criteria.

1.27. We would expect new licensees to comply fully with the provisions of SLC 11.3 from the date it has been granted. Failure to comply may result in form enforcement action by Ofgem.

Enforcement action

1.28. Ofgem expects companies to ensure they comply with their licence conditions. If they are found in breach of these conditions, the options available to Ofgem include:

- issuing an enforcement order to ensure companies take action to comply with their licence conditions, (where there is a current or likely future breach) and/or
- imposing financial penalties of such an amount as is reasonable in all of the circumstances of the case of up to 10 per cent of turnover.

1.29. The Authority's powers are provided for under the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998 and the Enterprise Act 2002. Ofgem's approach to use of its enforcement powers is set out in its enforcement guidelines²².

Licence revocation

1.30. Ofgem would also consider revoking a supply licence issued with a direction under SLC 11.3 if the licensee were found not to be complying with SLC 11.3 and had failed to act in accordance with an enforcement order.²³

1.31. In deciding whether or not to revoke a supplier's licence with a direction under SLC 11.3, Ofgem is likely to take into account (but not necessarily limited to) the following issues:

- The potential impact on customers and other industry parties of non-compliance.

²² <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=4&refer=About%20us/enforcement>

²³ Contained in Schedule 2 to the Supply Licence.

- Circumstances relating to non-compliance such as the breakdown of arrangements from a third party licensed supplier.
- Agreement by the small supplier or DE scheme to pay the energy balancing costs and network charges incurred from supplying electricity.
- Potential for alternative arrangements to be struck with another third party supplier.

Revocation procedure

1.32. Ofgem must consult with the licensee before revoking or amending a licence. Ofgem will take all reasonable steps to contact the relevant person at the supply business. This will enable us to raise and clarify any concerns we have and to explain the regulatory position and powers. This contact will also provide the company an opportunity to provide reasons why its licence should not be revoked. Ofgem would make clear the timescale for making such representations. This will depend on the urgency of the situation and in particular the impact on customers and other industry parties of delaying a decision to allow time for further representations or for alternative solutions to be found.

1.33. Ofgem must publish reasons for revoking a licence.²⁴ Once we have decided to revoke, we will issue a Notice of revocation and, simultaneously, a Notice giving reasons.

²⁴ Section 49A(1)(a) Electricity Act 1989.

Appendix 4 – The Authority’s Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority (“the Authority”), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Act 2004 , as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.²⁵

1.3. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly²⁶.

1.4. The Authority’s principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of existing and future consumers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors.

1.5. The Authority must when carrying out those functions have regard to:

- the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- the need to secure that all reasonable demands for electricity are met;
- the need to secure that licence holders are able to finance the activities which are the subject of obligations on them²⁷;
- the need to contribute to the achievement of sustainable development; and
- the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.²⁸

1.6. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

²⁵ entitled “Gas Supply” and “Electricity Supply” respectively.

²⁶ However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

²⁷ under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Act in the case of Electricity Act functions.

²⁸ The Authority may have regard to other descriptions of consumers.

- promote efficiency and economy on the part of those licensed²⁹ under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity; and
- secure a diverse and viable long-term energy supply.

1.7. In carrying out the functions referred to, the Authority must also have regard, to:

- the effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.8. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation³⁰ and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

²⁹ or persons authorised by exemptions to carry on any activity.

³⁰ Council Regulation (EC) 1/2003

Appendix 5 - Glossary

B

Balancing Mechanism

A market-based mechanism that enables National Grid to instruct generators and suppliers to vary electricity production or consumption close to or in real-time, in order to maintain safe operation of the system.

BSC

The Balancing and Settlement Code: Industry code covering the rules for electricity balancing and imbalance charges in Great Britain

C

Cash Out Arrangements

Arrangements whereby generators and suppliers pay or are paid for imbalances i.e. shortages and surpluses of power relative to their contracted commitments.

CHP

Combined Heat and Power: A technology where electricity is generated at or near the place where it is used, with the heat produced being used for space heating, water heating or industrial steam loads. This potentially leads to much higher efficiency than conventional generation.

D

DECC

Department of Energy and Climate Change.

DEWG

Distributed Energy Working Group: A working group set up by Ofgem and BERR to discuss the commercial, environmental and regulatory issues arising in the context of small, low carbon generation, and potential solutions to these problems.

Distributed Energy/Distributed Generation

Any generation which is connected directly into the local distribution network, as opposed to the transmissions network, as well as combined heat and power schemes of any scale. The electricity generated by such schemes is typically used in the local system rather than being transported for use across the UK.

DNOs

Distribution Network Owners: Monopoly providers of local, lower voltage electricity networks.

DUoS

Distribution Use of System charges: Charges paid by generators and suppliers for the use of the distribution network

E

Elexon

Elexon is the Balancing and Settlement Code Company (BSCCo) for Great Britain. It is responsible for providing or procuring the services necessary to operate the industry arrangements enshrined by the Balancing and Settlement Code (BSC).

Embedded Benefits

Benefits gained by smaller generators by avoiding the charges associated with use of the electricity transmission grid and becoming signatories to the BSC.

Exempt Supply Services

Services provided to exempt suppliers by a licensed supplier. These might include meter registration, data processing, and providing top-up and back-up services.

Exemption Order

The Exemption Order 2001 allows schemes of under a certain size to operate without the need to apply for a generation, distribution, and/or supply license. For generation, the limit is 100MW when consumption is for own use, or 50MW where it is for on-site third party use. For distribution, the limit for residential load connected via a private wire is 1MW, and for supply the limit is 1MW for residential customers supplied on-site or via private wires.

M

MPAN

Meter Point Administration Number: A unique number relating to a metering point under the MRA

MRA

Master Registration Agreement: The agreement that sets out terms for the provision of Metering Point Administration Services and procedures in relation to the Change of Supplier to any premise/metering point.

P

PPA

Purchase Power Agreements: are purchasing agreements with third parties.

Private wire

'Private wire' is often used as shorthand for a direct and exclusive connection between a consumer and a generating station that is not on the same site. The term has specific connotations in the context of the electricity system, being associated with small distribution networks and exemptions from the need to hold electricity licenses.

Public wire

Public wire refers to the licensed distribution network.

R

Renewables Obligation (RO)

The government's main support programme for renewable energy generation, under which electricity suppliers must source a proportion of their supply from renewable generation.

ROCs

Renewable Obligation Certificates: Certificates received by eligible renewable generators for each MWh of electricity generated. These can be sold to suppliers in order to fulfil their obligations under the RO.

T

Top-up/Back-up

Additional electricity provided to an exempt supplier by a licensed supplier to meet any shortfalls in production relative to customer demand and to cover plant outages due to failure or maintenance.

Z**ZCH**

Zero Carbon Homes: The government's zero-carbon homes policy, set out in the Housing Green Paper, "Building a Greener Future", proposes that all new homes in England should be zero-carbon from 2016.

Appendix 6 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

- Does the report adequately reflect your views? If not, why not?
- Does the report offer a clear explanation as to why not all the views offered had been taken forward?
- Did the report offer a clear explanation and justification for the decision? If not, how could this information have been better presented?
- Do you have any comments about the overall tone and content of the report?
- Was the report easy to read and understand, could it have been better written?
- Please add any further comments?

1.2. Please send your comments to:

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