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'Licence Lite': proposed updates to the SLC 11.3 operating guidance

Dear Kate,

SmartestEnergy welcomes the opportunity to respond to Ofgem's Consultation on 'Licence Lite': proposed updates to the SLC 11.3 operating guidance.

SmartestEnergy has been an aggregator of embedded generation since 2001 and a supplier in the electricity retail market serving large corporate and group organisations since 2008.

Please note that our response is not confidential.

Overview

In summary, we believe that only time will tell whether Licence Lite can truly differentiate itself from a Third Party Intermediary (TPI) or White Label arrangement or even a simple PPA and supply agreement. This may depend on how Ofgem feel about some companies remaining "below the radar" while seemingly similar companies are subject to licence obligations which are just subcontracted. We understand that there may be some synergies achievable for organisations which already have a customer relationship (as Local Authorities do through Council Tax billing). However, we do not believe that the concept of Licence Lite offers any real value for truly independent generation over and above commercial arrangements that can already be negotiated with Third party Licenced Suppliers (TPLSs). Indeed, the requirement for separate MPIDs may increase these costs. We believe that more detail on the business cases should be released by the public bodies in question to better our understanding of the advantages of Licence Lite.

For your information SmartestEnergy can offer "source to supply" contractual arrangements which would obviate the need for a Licence Lite arrangement.

In the consultation document Ofgem note that since the introduction of the Licence Lite guidance no parties have applied for a direction. Ofgem put forward the view that one potential reason is a lack of clear understanding amongst aspiring suppliers over the precise

functioning of a Licence Lite arrangement and the balance of responsibilities between parties. Other "barriers" are also mentioned.

It is true that the Licence Lite arrangements leave the balance of responsibilities between parties unclear. But this has been a good thing in that it allows parties to explore different commercial arrangements while the licence obligations remain fixed. We agree with Ofgem, therefore, that the focus of this consultation should just be on clarifying the licence obligations.

In our view, however, the major reason for a lack of uptake is more to do with the fact that the arrangements do not align with the aspirations of potential Licence Lite Suppliers (LLSs). In essence, some parties perceive that there is a large gap between what they pay for electricity and what is achievable for embedded generation. However, there are two fundamental truths which explain this:

Firstly, all embedded benefits under the current arrangements go to the generator, so even if an organisation (distributed energy scheme) combines some generation and demand into a package as a pseudo self-supply, the generation will demand the revenues it could get as a standalone embedded generator and it will look as though the demand is not seeing its share of the embedded benefit even though it is contractually offsetting.

Secondly, in some local arrangements, a large proportion of the remaining cost differential is in the DUoS charges as these take no account of the contractual arrangements and can effectively be paid twice even if little of the network is used physically. Many of the real benefits can only be realised on private wires.

The margin the supplier takes is also given as a reason to explore licence lite. However, retail margins in the non-domestic sector in our experience are only 0.5 – 2.0%

Ofgem correctly identify IT costs and imbalance as reasons why small parties would find it difficult to become suppliers. The complexity of code and licence compliance also requires a level of expertise that is not necessarily freely available to embedded generators. However, the licence lite arrangements per se add nothing to the current alternative viz. use another supplier, and do nothing to reduce the costs. From what we can see a Licence Lite proposition (in conjunction with the proposed clarifications) appears to sub-contract all of the elements of a supplier to the extent that it is a supply contract (save for the social and environmental obligations which we believe the potential licensees would not see any value in retaining). The clarified requirement to use a separate MPID will not satisfy aspiring LLSs and will merely make any proposition more expensive than would be the case under a contract.

When we consider the lack of obvious advantages for licence lite, the complications a separate MPID brings and the SoLR requirements we do wonder whether the whole concept is worth persevering with.

Having said all of the above, we believe it is worth continuing with the Licence Lite concept for the time-being to see if it can differentiate itself from TPI and White Label (especially in the area of billing) and, overall, Ofgem's proposals clarify the ground rules for such a concept to be further explored commercially.

We answer the questions contained in the consultation in the order in which they appear below.

Question 1: Are further clarifications regarding the functioning of a Licence Lite arrangement required from the regulator, and if so, in what areas?

> We note that a Licence Lite applicant must demonstrate that they have robust arrangements in place with a TPLS. However, it occurs to us that there appears to be no on-going requirement for those "robust" arrangements to remain in place. It should be an immediate licence/guidance requirement for the LLS to inform Ofgem should the contractual arrangements change in any material way, and possibly to re-apply.

Question 2: Do you agree that our position over the balance of responsibilities and regulatory obligations is: a) sufficiently clear to allow parties confidence to enter into commercial agreements, and b) a proportionate approach?

> It is sufficiently clear to us that i) the TPLS is accountable to Ofgem for Code Compliance even where the MPANs in question are assigned to a Licence Lite MPID and ii) the LLS is responsible for social and environmental obligations (even though he will probably transfer responsibility for this operationally to a TPLS)
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> We are not entirely convinced that this lack of clarity is what has inhibited parties from applying for a Licence Lite licence in the past. But we agree that the approach is proportionate for the time-being. Clearly, the arrangements can be revisited once some Licence Lite relationships have evolved. It would be wrong to conclude, however, that the absence of any LLSs is automatically a negative thing. It could easily be a function of commercial reality.

Question 3: Do the Licence Lite arrangements relating to the Smart Energy Code – as set out in this consultation and in paragraphs 1.39-1.41 of the proposed guidance – provide sufficient clarity over roles and compliance obligations between parties?

> Ofgem state that they will consider any application for a derogation under SLC 48.2 on a case by case basis. On the face of it this makes sense as it is possible that some business models may differ.
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> However, we would anticipate all applicants will seek a derogation from the SEC as it is akin to the MRA from which there is an automatic exemption. We wonder whether Ofgem should consider now including the SEC as one of the other codes.

Question 4: Do the Licence Lite arrangements relating to the Electricity Market Reform – as set out in this consultation and in paragraphs 1.42-1.46 of the proposed guidance – provide sufficient clarity over roles and compliance obligations between parties?

The way in which the exemption is structured in the licence and the wording in the guidance both make it clear that responsibility for complying with social and environment schemes (such as the CfD Supplier Obligation) remains with the Licence Lite Applicant, even if they establish a commercial relationship with a TPLS. This is correct, otherwise the arrangement is completely indistinguishable from other types of arrangement such as TPI or White Label.

Question 5: Do the Licence Lite arrangements relating to the government's social and environmental programmes – as set out in this consultation and in paragraphs 1.42-1.46 of the proposed guidance – provide sufficient clarity over roles and compliance obligations between parties?

We wonder what would happen in the instance of a company which has been granted a licence (with no derogation) but which chooses to use a White Label approach and leave the licence dormant. Would Ofgem want to revoke the licence? How would they know about the White Label arrangement?

The problem for a company in this situation is that if they have their licence revoked it might appear that they should not be operating even in a White Label arrangement.

Question 6: Does the potential impact of the MPID restriction warrant a modification to the Balancing and Settlement Code?

It is true that there is a restriction of two MPIDs per supplier. If a TPLS feels that this is restrictive they should raise a modification. It would be wrong for Ofgem to direct change where there is no proven need.

There have been suggestions that it would be better to use BMUnits rather than MPIDs. On the basis that a Licence Lite arrangement is more likely to be a "local" arrangement, this seems relatively sensible if Ofgem can get the data they need direct from Elexon. However, consideration needs to be given as to how Ofgem would be informed of the use of further BMUnits which were not part of the original application.

We are assuming that responsibility for gaining MPID accreditation will rest with the TPLS. There is probably no need to modify the BSC for these purposes; TPLSs can apply to have an additional MPID with a set of Base BMUs on behalf of any LLS they are in contract with. However, some thought needs to be given to the fact that it will be assumed under the BSC that the MPIDs will belong to the TPLS, and for imbalance purposes, this may be correct. In the event of a breach of the Supply Licence, Ofgem will wish to pursue the Licence Lite Supplier for whom the MPID has been set up. There, therefore, needs to be a mechanism by which Ofgem links the Lite Licence to a specific MPID which they do not currently have. A change to the BSC would be unnecessary but one of the requirements of Licence Lite must be that all MPIDs/BMUs are declared at the time of application or as soon as they become operational.

There may also be an issue for the EMR Supplier Obligations, as Elexon may not know the nature of the contractual arrangement between the LLS and TPLS and who to send the bill to. This is not a BSC issue. As it is stated that environmental obligations fall to the LLS, it would seem appropriate that the LLS must register its interest with Elexon.

Question 7: Are there any complications (not identified in the consultation) to uniquely identifying a Licence Lite Supplier's customers on central systems?

As well as the issue of the BSC only allowing two MPIDs per Supplier there is also the matter of additional cost. Some TPLS will incur additional IT costs to incorporate an additional MPID into their system as there could be licensing issues with their IT provider.

Having said that, we understand that the existence of a separate MPID is required to facilitate a SoLR direction and to accurately assign environmental and social obligations. The document states correctly that LLSs must ensure that their customers are uniquely identifiable within MPAS (and therefore within the TPLS systems). However, it states that "one way to achieve this" is through the use of a unique MPID. We believe this is the only way under Licence Lite but the document implies that there may be others. The BMUnit approach does not meet the requirement of being uniquely identifiable in MPAS nor the facilitation on an SoLR direction.

Because some TPLSs will be reluctant on the grounds of cost to offer an additional MPID solution the pool of such suppliers offering services to LLSs will be severely limited. We believe that competition is best served if parties considering such arrangements simply enter into normal PPA and supply agreements.

Question 8: Are the risks to Licence Lite suppliers inherent in the current operation of supplier of last resort arrangements in the event of TPLS failure sufficient to justify backstop measures, and if so, what measures would be appropriate and why?

If a LLS were to fail, Ofgem state that they would "anticipate" a deemed contract arising between the Licence Lite customers and the TPLS. This seems not unreasonable and it is not worth drawing up special SoLR procedures.

The deemed contract solution may mean that Ofgem should be less concerned about the use of a separate MPID which is not without its downsides.

The existence of a deemed contract does, however, place a significant risk on the TPLS who may struggle to engage with the customers for payment. The deemed contract concept needs formalising as a requirement in the contracts the LLS has with its customers.

The document does not explicitly state what would happen to the RO obligation. Licence Lite suppliers may be small with little credit support. Ofgem should be wary of allowing a proliferation of entities which could walk away from the various obligations

(such as the RO which does not require credit collateral) and in effect pass additional mutualisation costs onto other suppliers.

Question 9: Is the information required for a Licence Lite application appropriate for all potential applicants?

No comment.

Question 10: Are there any relevant milestones which are omitted from the proposed guidance?

No comment.

Should you require further clarification on this matter, please do not hesitate to contact me.

Yours sincerely,

Colin Prestwich

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