temple bright

81 Rivington Street
London EC2A 3AY
T. +44 (0) 20 7183 2101
F. +44 (0) 845 450 1231

www.templebright.com

Ofgem
9 Millbank
London
SW1P 3GE

For the attention of: James Luger/Kate Thompson

By email only: sustainable.energy@ofgem.gov.uk

5 December 2014

Dear Sir/Madam

Ofgem consultation: 'Licence Lite': proposed updates to the SLC11.3 operating guidance

We write in relation to the above consultation and, in this letter, set out some general observations on the "Licence Lite" scheme, as well as putting forward our responses to the questions raised.

As legal advisors who have been actively involved in the distributed generation market generally, as well as providing route-to-market legal support for a number of years, Licence Lite has always been something of an enigma.

Just before SLC11.3 was introduced, we had been advising a distributed generator client locked in negotiations with a number of existing licensed suppliers, trying to buy services from them that would have allowed it to become a local supplier. Those negotiations and the contracts we were asked to review, made it clear (if it wasn't already) that suppliers who have already overcome the regulatory and administrative barriers to obtaining and operating under a supply licence aren't welcoming to potential 'new entrant' competitors. SLC11.3 created a vehicle for operating as a licensed supplier, with a somewhat reduced regulatory burden, but did nothing to address the fundamental barriers to new market entrants that our clients had experienced prior to the introduction of SLC11.3. Unsurprisingly, those clients gave up and most people we are aware who have considered using SLC11.3 since, quickly came to the same conclusion.

No surprise then that Ofgem has not had to address the challenge of considering a Licence Lite application (until recently). For a number of years, Ofgem has argued that there was no evidence of market failure unless/until they received evidence from a Licence Lite applicant but, since there had been no applicant, there was no evidence to consider. Cynics might view things differently. However, the GLA made its application and, now, the issue has to be confronted.

The significance of the GLA's application cannot be overstated. The GLA has chosen to reduce the challenge to its simplest level: a strong entity applying for a licence, starting with just one, strong, commercial customer with substantial electricity demand, all in one city. If the GLA are successful, it proves that Licence Lite is *capable* of working. Of course, that is very, very different from saying that it is a flexible model that suits everyone. But, if they fail, it is unlikely that anyone else could succeed and, therefore, it will be as definitive proof as is possible that Licence Lite is *incapable* of working and evidence that Ofgem does need to intervene to address this market failure.

In a number of areas, we view Ofgem intervention as necessary regardless and we set out our particular concerns in response, below, to your consultation questions.

Temple Bright LLP is authorised and regulated by the Solicitors Regulation Authority. It is a limited liability partnership (number OC352276) registered in England and Wales. Its registered office is at the above Bristol address where a list of members is available for inspection. The term "partner" includes members, employees and individual or corporate consultants (and their principals). We do not accept service of proceedings by email or fax.

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

Response: Licensed electricity supply is a highly complex area. As your consultation document implies, Licence Lite may be something of a misnomer. All other SLCs apply, depending on the nature of the intended customer base, still imposing a significant administrative burden. The justification for this is primarily concerned with consumer protection and smooth operation of the electricity market (the current structure of which, of course, is itself the product of regulation, rather than something absolute). In that context, many people who express interest in Licence Lite are quickly disheartened when they discover the extent of that complexity.

It is outwith the scope of this consultation to discuss whether any alternative structures might be better but what was clear from the workshop session was that there was considerable demand for more information about Licence Lite and alternative vehicles for use by distributed generators, local authorities, community energy groups and others.

Suggestion: In our view, the consultation document itself sets out a clear and helpful, quick guide to a number of possible alternative approaches to the "conventional" generator-supplier-consumer relationship. This could be built upon further, perhaps in collaboration with DECC.

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?

Response: Clarification about TPLS regulatory responsibility for compliance/failure connected with SLC11.2 codes is helpful. This confirms the principle that has been understood to be intended but concerning which there remained some doubt.

However, the guidance then creates ambiguity in paragraph 1.59.

"1.59. In the event of a TPLS failing to meet its obligations under the agreement, a Licence Lite supplier may be in breach of SLC 11.3 by not having in place arrangements to deliver SLC 11.2 Code compliance. If a Licence Lite supplier is deemed to be in breach, Ofgem will take decisions on enforcement action in line with its Enforcement Guidelines."

Whilst in principle, this statement must be correct, it reveals the weakness in relying on guidance to allocate regulatory responsibility. A contract can never guarantee an outcome. It can only set down rules for what happens if a particular eventuality arises. Where LL obliges TPLS not to breach the agreement or, more specifically, the codes, it can only then provide for a range of remedies if TPLS does what is contractually forbidden. If the remedies are too severe and are enforceable, TPLS will not enter the agreement.

Consequently, in our view, notwithstanding any clarification on on this point, given the imbalance in bargaining positions that will be typical of negotiations between any subsequent LL applicants and the TPLSs with whom they would be negotiating, there is still significant merit in wholesale modification of SLCs to confirm where SLC11.2 responsibility lies. The value in doing so is that it then avoids this being a significant negotiating point and makes "industry standard" wording on the point becoming much more readily achievable.

Achieving "industry standard" wording will be a recurring theme in this response. Without it, or without a supplier obligation that supports Licence Lite and a standardised approach, LL applicants will continue to experience high transaction costs associated with procuring TPLS services. And, even if they get past that hurdle, they face the prospect of high transaction costs again when their SSA term expires or if there is an early termination for any reason.

That leaves the LL applicant or LL holder in a particularly precarious position and seriously threatens the business case.

Suggestion:

(i) Remove the ambiguity created by paragraph 1.59 in the guidance; and
(ii) Issue general SLC modification which confirms this balance of responsibilities.

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?

Response: Yes.

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?

Response: Yes.

Suggestion: Ofgem keeps the guidance under regular review, updating it as relevant and/or expanding guidance if it becomes apparent that there is a need to do so.

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?

Response: Yes - but this is dependent upon and presupposes that LL and TPLS customers (and associated supply volumes) can be readily distinguished. Provided this is the case, then we have no grounds for saying that LL should be assessed against any different criteria than other licensed suppliers. However, no guidance is given as to responsibility for LL breach flowing from TPLS failure to supply data.

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

Response: Possibly – but this seems to depend on the answer to the question implicitly asked by Ofgem: do any suppliers interested in offering TPLS services have too few MPIDs to take on and distinguish LL customers? If the answer is no, or Ofgem is aware that many suppliers have a shortage of MPIDs, then, even if the process would take several months, it seems appropriate to pursue BSC modifications needed to increase numbers.

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

Response: During the LL workshop, a view was expressed (and reported in your record of the event) that the above approach: (i) would be costly; and (ii) could be avoided by using BMUs instead. The objective is to distinguish LL and TPLS customers and it is in the interest of all parties to keep costs to a minimum. If the BMU approach works, is simpler and cheaper, then it should be pursued. However, it seems to us that the BMU approach pre-supposes a specific geographic location (within a BMU) for LL customers that has to be distinct from TPLS's

customers. If that is correct, then adopting this approach would inherently limit the application and scalability of LL.

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?

Response: As noted above (in response to Q2), yes. Consumers are protected against LL failure through existing SOLR mechanisms. That also operates to protect them in the event of TPLS failure. However, that doesn't afford any protection to LL's business. There needs to be more certainty that there is a liquid market for TPLS services.

Ideally, that would come about as a market reaction from fully licensed suppliers to LL demand. Of course, LL demand failed to materialise for a number of years because no-one believed that there were suppliers prepared to offer TPLS services on reasonable terms. The GLA are taking a bold step to test the hypothesis. But, even if they succeed in securing TPLS services in order to establish themselves, that doesn't address expiry or early termination of their agreement with TPLS (whether or not related to TPLS insolvency or loss of licence).

In the absence of any certainty that there will be a TPLS prepared to contract with LL on acceptable terms, at that point in time, most people interested in entering the supply market, any private investor looking at Licence Lite would be forced to consider their investment in terms of the length of their initial SSA term – unless and until they can see that a market does exist for it to continue. And, although TPLS insolvency or loss of licence might be a very low risk, it is only one of the reasons the SSA might be terminated early, so even the term of the SSA is not fully secure. That realisation could well put off many potential LL applicants, which in turn prevents the market for TPLS services from growing.

Related to this point, we note the following statement in paragraph 1.64:

"However, a Licence Lite direction will remain in place if a Licence Lite supplier changes their TPLS as long as there is no material change to the supplier services agreement or other arrangements for SLC 11.2 compliance."

What is a material change? This statement highlights the risk associated with changing TPLS – whether voluntarily (looking for better terms) or involuntarily (because of TPLS breach). What is a material change? In the absence of either an obligation or a liquid market, terms and conditions negotiated will be different even if a willing TPLS can be found. Standardisation has to be the solution but won't come without an obligation or significant demand. And so the loop continues.

For that reason, if Licence Lite is to succeed, then an essential part of helping a market in TPLS services to grow is for Ofgem to modify SLCs to require the provision of TPLS services – although we do recognise that this is no simple matter.

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

Response: -

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

Response: Whilst we recognise that this is very much a "pioneering" stage in the development

of Licence Lite, if/when it is known that Licence Lite is capable of working, Ofgem should accept some time limits for processing LL applications.

We hope that the above comments are useful and remain at your disposal to discuss any of the issues we have raised.

Yours sincerely

Tom Bainbridge
Partner (London)
Temple Bright LLP
M: +44(0)7454 779 892
T: +44(0)20 7139 8209
E: tom.bainbridge@templebright.com