

# Supporting community energy and local electricity markets

## An alternative proposal

### Overview

This paper is not intended to replace previous submissions by Power for People and others on the Local Electricity Bill, which has received active support from a large number of MPs.

It:

- Explains the derivation of the paper and the opportunity community energy and local supply advocates have been provided with to help develop BEIS's thinking
- Does not repeat previous submissions and arguments for change based on changes to cost allocation rules, but
- Focuses on a number of policy and regulatory interventions made over recent years to modify licensing and market rules to deliver wider policy goals, and
- Demonstrates that there are mechanisms potentially available – if suitably amended – to remove barriers to market access for community energy and suggests how these might work.

The paper has been written by Nigel Cornwall on behalf of Power for People, and it has been reviewed by a panel of community energy and industry experts.

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## 1. Introduction

For the Government to meet its Net Zero Strategy and hit the Net Zero Target, it needs a portfolio of ambitious measures at both national and local level. National targets largely based on clean technologies are receiving significant focus. However, community energy production from renewable generation assets and supply to local consumers also has an important role to play. The Government needs therefore to take action to support local supply from community energy and address current electricity market distortions that arise from a national market and regulatory regime that are effectively preventing its take-up.

The paper:

- Explains the immediate context of supplier licensing and the costs and complexity that flow from this that effectively deter community-based players from becoming suppliers
- Sets out the background to current debates on supporting community/local energy, including that around the Local Electricity Bill currently before parliament
- Comments on the current market context and the beneficial implications this holds for continued community energy developments – primarily retention of value to local stakeholders, increased security of supply and local resilience - if issues around its deployment can be addressed
- Identifies interventions that have already been made to the current regulatory regime that have tried to address other market distortions and that have been identified as misaligned with the Government's policy objectives
- Explains why current policy and regulatory mechanisms often cited in debates on community energy are inadequate and need modernising to align with Net Zero. These include:
  - the recent innovation that allows a supplier to apply for a local licence
  - the very limited scope for obtaining licence exemptions, and why these are not fit-for-purpose in the context of community energy
  - the provisions introduced by the Smart Export Guarantee, which do not provide sufficient market certainty
- Explains why we believe the current "licence-lite" (or junior supplier option) introduced in 2009 specifically to support deployment of distributed generation schemes is unusable
- Goes on to propose a light-touch approach to shoring up existing arrangements (which we term the Community Electricity and Supplier Services Guarantee) that, we believe, could provide a suitable safety net for community-based generation and local supply, and
- Identifies other potential policy levers.

We are not seeking subsidy for community energy, but there is a very strong case in our view for some form of minimum revenue support and a relatively simple route to market - perhaps offered on a transitional basis - that larger suppliers should be required to offer.

Without some intervention, supply chains will become weaker and new small-scale generation investment, including community energy, will be slower, later and more expensive. This could have a material and adverse impact on the cost and timing of delivering Net Zero.

## 2. Supplier licensing

The supply of electricity is a prohibited activity under the Electricity Act 1989, and it can only be carried out by a licensed party. Ofgem is responsible for issuing licences and administers the conditions set out in a licence and compliance with them.

Ofgem has produced guidance on the process that must be followed, the information it requires and the considerations it takes into account in determining the award of a supply licence.<sup>1</sup> It also has issued a risk assessment template that must be completed. The process more generally and the individual steps are set out in the 2019 Applications Regulations.<sup>2</sup> These included a modification to enable an applicant to seek to supply to a specified area only.

The 500-plus page licence is usually national in scope unless a supplier seeks to define a specific region. That said, a supplier going through market entry still has to demonstrate it has systems that communicate with all other suppliers and their various agents (meter operators, data collectors etc.). This series of relationships is termed the 'supplier hub'.

Costs of market entry are variously and conservatively assessed at anywhere between £250,000 to £1,000,000. These fell significantly last decade but have tended to rise again as Ofgem has implemented tougher entry requirements and on-going checks to test supplier viability following failures during the period 2018-19. Suppliers also have to provide significant levels of credit across a variety of centralised industry codes.

Because of the complexity of the hub and the depth of the compliance requirements under the licence and industry codes that give effect to it, the licence regime was varied in 2009 to introduce the "licence-lite" mechanism. This is described further at 4(d) below. Ofgem also included new arrangements in 2019 for a party to be licensed to supply a defined geographical area.

So, while it is not strictly accurate to assert that the licensing regime is "one size fits all" owing to the ability to negotiate licence-lite arrangements and also to specify regional coverage, the costs and compliance requirements for any supply to be made to consumers are wide-ranging and seen by small players, including community energy providers and local suppliers, as prohibitive.

## 3. Policy developments, including the Local Electricity Bill

In 2014 the Coalition Government brought forward the country's first community energy strategy.<sup>3</sup> This was updated in 2015.

However, since 2015, there has not been specific policy support. Indeed, the right to gain access to the market through a licensed supplier with a guaranteed price previously available through Feed-in Tariffs has been removed. This has led to many community generation projects being scrapped and a collapse in new schemes coming forward. In 2019, the last year where schemes under the Feed-in Tariff (FiT) were commissioned, only 15.4MW of new community owned capacity was added, and in 2020 that figure fell to 8MW. The adoption of the Net Zero Target in June 2019 and debates around the Local Electricity Bill, which is a Private Member's Bill and which has been on-going for over two years, have brought increased focus.

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<sup>1</sup> <https://www.ofgem.gov.uk/sites/default/files/2022-03/Applying%20for%20a%20gas%20or%20electricity%20licence.pdf>

<sup>2</sup> [https://www.legislation.gov.uk/uksi/2019/1023/pdfs/ukxi\\_20191023\\_en.pdf](https://www.legislation.gov.uk/uksi/2019/1023/pdfs/ukxi_20191023_en.pdf)

<sup>3</sup> <https://www.gov.uk/government/publications/community-energy-strategy>

There has also been an inquiry by the House of Commons Environmental Audit Committee (EAC) in 2021 that resulted in a letter to BEIS calling for action.<sup>4</sup> The letter called for a reintroduction of an export price guarantee and a minimum contract period, as well as for policy makers to build a better understanding of the reasons for success for community energy overseas.<sup>5</sup>

The Secretary of State's response was seen by many advocates of community energy as disappointing, with him notably deflecting the calls for an export floor price and/or minimum contract length. It also noted that the Government's approach would be set out more fully in the Net Zero Strategy.<sup>6</sup>

In its current form the Bill being promoted by Power for People was reintroduced by David Johnston MP (Conservative, Wantage) on 21 July 2021 and had its first reading in the House of Commons on 1 November 2021.<sup>7</sup> It is termed a Presentation Bill. It is currently before parliament and has attracted a very high level of cross-party support from over 300 MPs and reflects a strong desire among MPs "to do something" to support community energy schemes. The Bill does not specify a solution as such, rather leaving it to the energy regulator Ofgem to identify more proportionate ways of dealing with and allocating costs to local supply.

However, the Bill is seen by officials backed up by Ofgem as being distortive, shifting costs between customers, potentially creating a subsidy and giving rise to other unintended consequences especially for stranded customers who cannot benefit from local offers and/or who choose not to participate.

The arguments against the Bill were summarised by BEIS Minister Greg Hands in a parliamentary answer to Kate Osborne MP on 31 October 2021.<sup>8</sup> The Minister said:

"The Government agrees with the broad intentions of the Local Electricity Bill, but [it] does not support it as the means to enable local energy supply. There are already mechanisms in the market to allow local supply. The current Ofgem regulatory regime allows for a company to supply a specific geographic area, and small-scale generators can also apply for a licence exemption in some cases to reduce the regulatory burdens of operating at a community level."

"The Government supports community energy projects through the Rural Community Energy Fund and will work with Ofgem to ensure that local communities can play their role in delivering Net Zero and a Green Recovery."

The arguments were reprised in a Westminster Hall debate on 30 November 2021 in response to a motion on community energy schemes brought forward by Wera Hobhouse MP (Liberal Democrat, Bath).<sup>9</sup> In response, Greg Hands acknowledged the value of community-based schemes but before again restating the Government's opposition to the Bill:

"We understand that the value of community energy is not just in delivering energy projects that stimulate clean growth. Projects such as the community energy cafés run in south-east London support the most vulnerable in society by providing impartial domestic energy advice. Community groups can also act as the catalyst for raising awareness of

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<sup>4</sup> <https://committees.parliament.uk/publications/5718/documents/56323/default/>

<sup>5</sup> It also called for reinstatement of the Urban Community Energy Fund alongside the Rural Community Energy Fund and for Social Investment Tax Relief for community energy projects. It also recommended adjustments to National Planning Policy to allow prioritisation of community owned energy developments.

<sup>6</sup> <https://committees.parliament.uk/publications/6327/documents/69506/default/>

<sup>7</sup> An earlier version introduced by Peter Aldous MP (Conservative, Waveney) fell at the end of the previous parliamentary session.

<sup>8</sup> <https://questions-statements.parliament.uk/written-questions/detail/2021-10-20/59980/>

<sup>9</sup> <https://hansard.parliament.uk/Commons/2021-11-30/debates/3BBD1C16-2AA0-4642-87C3-9D857E285580/CommunityEnergySchemes>

both the energy system and wider environmental issues. They can be a catalyst in the promotion of behaviour change, which we all know is vital to reaching Net Zero."

On this occasion, the Minister in his response to the debate agreed to arranging further talks between proponents of the Bill with officials to identify areas of agreement and to close out points of difference:

"I am certainly committed to examining the obstacles ... I am very happy to continue to engage with hon. Members, to look at the obstacles and to see what can be overcome, ameliorated or worked around. I am very keen to meet and continue the engagement with hon. Members. It is a little difficult for me to agree to remove the obstacles until we have scoped them out. The Department is well-aware of the obstacles, but if my hon. Friend has suggestions for how to overcome some of them, I am interested in working with him and like-minded hon. Members."

The date for the Bill's second reading has not yet been set but, following the 30 November debate, Power for People has been invited to discuss with officials the mutual support for the objectives behind the Bill and how these can be translated into meaningful action. An initial meeting was held between Power for People and officials on 16 February, and we were invited to provide specific comments on possible solutions.

This paper, which is being made available to officials and MPs, is therefore the next stage in this process.

#### **4. Market and policy context**

Since the Local Electricity Bill was introduced in 2019, the electricity market has experienced increasing turbulence. Indeed, recent energy market developments and aggressive cycling of wider commodity prices have highlighted the real and growing value of locally derived supply both in terms of cost and local resilience. The avoided cost benefit of clean energy produced behind-the meter has increased significantly, and it is set to increase further.

By 1 April 2022, when the default retail energy price cap is reset, energy bills will have doubled over the past twelve months to close on £2,000/year for average consumption, and it is likely that there will be further significant increases in October 2022 and April 2023. There appears little prospect of relief for consumers over the short to medium term, and it is still unclear how much further prices will be pushed up following the events in Ukraine.<sup>10</sup> Industry commentators such as Cornwall Insight were suggesting earlier this month that bills could rise to £3,000 by April 2023 and some more recent estimates are higher.

There is also a very strong interaction with Net Zero, and most community-based local supply arrangements are based around carbon-free renewable technologies. With increasing congestion around connection to the mainland system, we are already beginning to see an upswing in onshore developments at least by merchant developers.

Against this background, the Net Zero Strategy<sup>11</sup> published in October 2021 trails the increasing importance of community energy. It notes:

"Community Energy is an example of how communities can come together to reach local and national net zero targets. Community Energy England's 2021 State of the Sector Report outlined that there are 424 community energy organisations working across the UK to deliver a net zero future and with the appropriate support, they estimate that the community energy sector could contribute up to 5,270MW, power 2.2mn homes, support 8,700 jobs and add £1.8bn to the economy each year."

However, the Strategy does not really contain any specific measures to boost it or provide any indication of what it means by "appropriate support". It refers to the Rural Community Energy

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<sup>10</sup> Seasonal electricity prices are currently up at around £250/MWh.

<sup>11</sup> <https://www.gov.uk/government/publications/net-zero-strategy>, pp271-272.

Fund (RCEF),<sup>12</sup> an Ofgem decision to open access to the Industry Voluntary Redress Scheme to community schemes and a decision to re-establish the Community Energy Contact Group.

While any new supportive measures are obviously welcome, most stakeholders believe this is very low-level and that they will not on their own have the transformative impact the Government says it wants from increased community energy, even before the recent surges in fossil fuel prices that are having a very detrimental impact on consumer energy bills. Under current regulatory rules that do not provide open access to a secure market, it is hard to see where the impetus for this twenty-fold increase will come from.<sup>13</sup>

Consequently, build rates for community generation schemes are continuing to lag behind those seen in many other markets internationally, notably in Germany, the Netherlands and Denmark, and in 2020 very few new projects were added and from a very low base.

There was an upswing in local offers in the retail market in the latter part of the last decade but many of the companies offering these have failed and most remaining suppliers have withdrawn these, and few were associated with local renewable assets.<sup>14</sup> Investment in community energy, which has been fitful at best, has virtually dried up. Without focussed action to address the barriers, there is no prospect of this trend being reversed.

In fact, the GB energy market remains heavily centralised based on large remote generation projects and hugely dominated by large-scale suppliers who have a national footprint.

## **5. Relevant market interventions**

The energy market is characterised by a series of interventions to either support policy goals or to address potential market distortions that have been made piecemeal. These include the Energy Company Obligation (ECO), which is designed to fund energy efficiency measures and "affordable warmth", an obligation on suppliers to pay for Contracts for Difference (CfDs)<sup>15</sup> and for the cost of the Capacity Market auction. But these all predate Net Zero.

A series of lower-level interventions or innovations have also been made to address perceived market distortions, typically around small-scale energy. We identify five below.

### **a. Smart Export Guarantee**

The Smart Export Guarantee (SEG) was introduced in January 2020, designed in part to ensure a route to market for local small-scale low-carbon generation, defined as up to 5MW,<sup>16</sup> provided you have a smart export meter.

However, we consider this a very weak replacement for the export elements of the FiT regime as it provides no price certainty, guaranteed duration or route to market for generation below 5MW. Electricity suppliers with more than 150,000 electricity customers are obligated to offer a SEG, but there is no requirement on how much (save a floor at zero) or for how long.

The best offer in the market is presently offered by Octopus Energy with an export rate of 7.5p/kWh, which is for the first time above the FiT export rate for pre 2019 installed renewable generation. However, most offers by larger suppliers are still in the 3p-5p range. Three suppliers have increased their rates since 2020, but one has been significantly reduced.

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<sup>12</sup> RCEF is presently closed for new applications, and the original budget allocation is taken up. No plans for a successor have been announced, and it is looking as if the Shared Prosperity is seen as a replacement.

<sup>13</sup> The recent Energy Security Strategy refers to community benefits arising from local wind and infrastructure investments but does not otherwise mention community energy.

<sup>14</sup> Notable failures have been Robin Hood Energy based in Nottingham, Bristol Energy Company and a joint venture between Warrington Borough Council and Together Energy. Octopus makes available an offer for the GLA in London.

<sup>15</sup> Designed to provide revenue guarantees for clean generation but not available below 5MW.

<sup>16</sup> The 5MW ceiling applies to solar, wind, hydro and anaerobic digestion technologies.

It is unclear how many SEG customers suppliers have, but the general perception is that it is a buyers' market partly because national suppliers do not attach much importance to small parcels of distributed intermittent power and partly because of the impact that the removal of the FIT has had on projects below 5MW. Where generation schemes are continuing to be discussed, feedback is generally that the mechanism does not provide the certainty needed to allow larger, loan-funded schemes to proceed.<sup>17</sup>

Further detail on the SEG is shown at Box 1.

#### **Box 1 – Smart Export Guarantee**

Introduced in January 2020, the SEG requires suppliers with over 150,000 customers to offer a tariff for purchase of exports of generation provided they are delivered onto the system through a smart meter.

Solar photovoltaic (PV), wind, hydro and anaerobic digestion (AD) installations up to 5MW and micro-combined heat and power (micro-CHP) up to 50kW are eligible.

The tariffs must be available for a minimum of a year and can be adjusted periodically but must not fall below 0p/kWh. It is for the SEG Licensee to determine other contract terms, such as duration.

13 SEG tariffs are currently on offer ranging from 0.5p/kWh to 7.5p (average 3.25p/kWh).

#### **b. Offtaker of Last Resort**

Another intervention is the Offtaker of Last Resort (OLR) mechanism to ensure markets for renewables built under CfDs. The CfD is a long-term revenue guarantee for the production of low-carbon power but does not provide any commitment to purchase. Developers see this guarantee as important as they also need surety of purchase for the output over the assumed life of the project.

The OLR was introduced in April 2017 to address this issue. It is a government scheme that aims to promote the availability of a power purchase agreement (PPA) to developers that acquire CfDs. It is intended as a last resort to help renewable generators who cannot get a PPA through the usual commercial means and it provides a guaranteed market through large licensed suppliers who are obligated to compete in any auctions held for this purpose.

To date, the mechanism has not been used.

The implementation of OLR demonstrates that – if the Government perceives a need for a safety net to support low-carbon deployment – it can act.

Further detail is at Box 2.

#### **Box 2 - The Offtaker of Last Resort**

The OLR is available only to eligible renewable generators who have an Investment Contract (an early form of Contracts for Difference (CfD) contract) or a CfD. The scheme provides an alternative route to market for eligible generators by facilitating a backstop power purchase agreement (BPPA) between the generator and a licensed supplier. This is achieved through a competitive auction process – the OLR auction.

The scheme is designed so a generator can enter into a BPPA quickly. Statutory deadlines apply to all parties involved in the OLR process.

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<sup>17</sup> One community developer described the SEG as “neither smart, nor a guarantee” in its evidence to the EAC inquiry last year.

The terms of the BPPA have been set by the Government and can last no longer than 12 months. The licensed supplier will buy the electricity produced under a BPPA at a specified discount below the market reference price. The initial discount is set in the BPPA at £25/MWh adjusted by an inflation factor.

It is a competitive auction with winner agreeing to offtake power for 12 months (though can be terminated early by the generator if desired). Mandatory suppliers must bid against every lot, voluntary suppliers can choose whether to bid or not.

There is a levelisation process that ensures any costs (such as management fees) incurred by a supplier are socialised across all licensed suppliers (on a market share basis).

For single BPPA auctions, the successful bidder is:

- the bidder who submitted the lowest management fee, or
- if the lowest management fee is submitted by two or more bidders, the bidder who submitted its bid first.

For multiple lots, the burden is spread across all bidders, with the first lot going to the bidder with lowest fees and so on.

### **c. Licence exemptions**

As noted above in the debate on 30 November, there is also the licence exemptions regime. Basically, all electricity generation, distribution and supply can only be carried out under a licence issued by Ofgem unless it has been specifically exempted. To support these arrangements the Government has set in place a series of class exemptions for each separate licensable activity.

The current regime is administered by BEIS and has been in place since the Electricity Act 1989, which was followed by the Class (Exemption from the requirement for a licence) Order 2001, last amended in 2007.

Since then, the energy landscape has changed substantially, for example through the growth of distributed generation and renewables. Many new generation projects are limited by their developers to less than 50MW to ensure no licence is required. Similarly, there has been an upswing in so-called "private wire schemes" where activities can be carried out to live within supply exemption limits and thus avoid the need to acquire a supply licence.<sup>18</sup>

BEIS launched a call for evidence into the regime as it presently stands in late 2020.<sup>19</sup> This call for evidence was to find out how well the exemption regime has coped with these changes and how exemptions are currently being used in practice. It will inform a future consultation on changes to the regime, as part of a wider energy supply market review. The next stages of the follow-up for both the call for evidence and the review have yet to be notified.

It is correct to say that generation below 50MW does not require a generation licence and supply of less than 5MW does not require a supply licence either (provided domestic supply does not exceed 2.5MW). However, all electricity meters that connect to the public system must be registered within industry settlement, and to do that the meter registrant has to be licensed. We are not aware of an agency arrangement that functions in this way, and this "option" is not seen as available by community groups.

The call for evidence did note that BEIS "is also interested in exploring whether there are opportunities to extend the scope of exemptions (particularly around distribution and supply) and how that would assist with the Government meeting its objectives".

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<sup>18</sup> Private wire schemes involve generators and consumers connected by a wire other than one owned by a local distribution company, which would be deemed to be part of the public network.

<sup>19</sup> <https://www.gov.uk/guidance/electricity-licence-exemptions>



It is not clear what the Government's intentions are regarding changes, if any, to the exemptions regime going forward, and it is noteworthy that recent parliamentary answers and ministerial contributions to debates have not indicated any willingness to further review or modify the exemptions regime. Customer protections in the energy retail market have also tended to be systematically tightened in recent years and compliance requirements on suppliers have been increased. Consequently, we doubt significant change that might benefit community energy is likely to occur.

Box 3 sets out further detail.

### **Box 3 – Licence exemptions**

Licence exemptions come in two main forms – statutory class exemptions (across transmission, distribution, generation and supply) and individual exemption orders; with statutory class exemptions accounting for the majority of cases.

There is limited visibility on the scale and location of parties benefitting from statutory class licence exemptions as they are not required to notify Ofgem.

#### Generation Class Exemptions:

Largely used by small-scale renewables, CHP and some legacy generation at industrial sites

- Class A: Small generators – Generates less than 50MW, declared net capacity <100MW
- Class B: Offshore generators
- Class C: Generators <100MW that connected before 30.09.2000
- Class D: Generators never subject to central despatch

#### Distribution Class Exemptions:

Largely applies to private wire arrangements, e.g., factories, airports etc.

- Class A: Distribute up to 2.5MW to domestic consumers
- Class B: Distribute up to 1MW to onsite domestic consumers from onsite generation
- Class C: Distribute to only non-domestic consumers

#### Supply Class Exemptions:

Deployed on developments such as shopping centres, housing estates, airports etc.

- Class A: Supply <5MW (which they generate) and only 2.5MW to domestic consumers
- Class B: Resale of electricity supplied by a licensed or exempt supplier (e.g., landlords re-selling in a multi-tenanted property)
- Class C: On-site Supply (varied up to 100MW) which includes private wire schemes
- Class D: Offshore Supply

#### Generation Individual Exemptions:

- Typically used to give discretionary exemption for plant that just exceeds the limits for class exemption status

#### Supply and Distribution Individual Exemptions:

- Not considered appropriate in normal circumstances, but BEIS notes "*Applications for individual exemption where exceptional circumstances apply may still be possible.*"

#### **d. Licence-lite supply**

One of the first such interventions to specifically support smaller-scale renewable generation was the establishment of the "licence-lite" route to market. This was designed by Ofgem for local operators who did not have the scale or knowledge to participate in the national supply

market characterised by the complex "supplier hub" arrangements. It was implemented in April 2009.

Ofgem has claimed: "Uniquely, licence-lite:

- Enables market entry where your organisation does not have the capacity to interact with the technicalities of the energy system
- Supports a reliable and potentially more favourable market for distributed electricity generation (compared to selling in the wholesale market), and
- Allows a direct relationship with your customers."<sup>20</sup>

Three licences of this type have been issued since 2009, but none have proceeded to operation, and none have involved community energy groups. It also appears that suppliers are reluctant to agree to offer such terms and have instead relied on white label offerings to support local energy offers (see below).

Further detail is at Box 4.

#### **Box 4 – Licence-lite supply**

Licence-lite is an arrangement whereby a newly entering licensed supplier can contract with another licensed supplier who discharges certain code compliance arrangements, mostly involving settlement for any uncontracted trades, on its behalf. It is a bit of a misnomer as it still requires compliance with all other aspects of the 500+ page electricity supply licence.

To give effect to such arrangements, the licence-lite supplier would need to negotiate and enter into a supplier services agreement in a form approved by Ofgem. The counterparty would be an already active licensed supplier, who in effect would discharge compliance requirements under the "designated" industry codes (including the Balancing and Settlement Code and the Meter Registration Agreement/Retail Energy Code) on its behalf.

In our opinion, there are fatal weaknesses in the arrangements as they currently stand, including:

- There is no obligation on the supplier to offer terms or that, if they do, they must be reasonable
- The arrangements for implementing such a requirement depend on execution of an agreement that is in a form agreed by Ofgem, but it is unclear how such an agreement would be structured
- There is no mechanism for determining disagreements between the parties other than those in the contract, which has been seen by interested parties as very one-sided in the interests of the already licensed supplier, and
- The term licence-lite is a misnomer as it only switches off one requirement in the supply licence so that the incoming (or junior) supplier is still subject to all other provisions.

I spent several years exploring development of such an arrangement between the GLA and one large supplier, and the whole deal became very complicated. Negotiation of the agreements and the issue of the licence-lite licence took almost nine years, and a brief pilot revealed a loss of over £200,000 to the GLA. The formal agreement was never switched on, and the contract was terminated in November 2018, and the GLA ended up developing an alternative white label arrangement with Octopus Energy.

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<sup>20</sup>

[https://www.ofgem.gov.uk/sites/default/files/docs/2015/04/482\\_an\\_introduction\\_to\\_licence\\_lite\\_factsheet\\_web\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/04/482_an_introduction_to_licence_lite_factsheet_web_0.pdf)

The GLA commissioned a post-mortem report from Element Energy.<sup>21</sup> This concluded: "The Licence Lite scheme revealed that involvement in novel energy market regulation is complex, time consuming, and involves a high degree of uncertainty. While the scheme successfully developed a new regulatory route to market for suppliers through the 'licence lite', it may not have represented the 'lower barrier' route to market originally intended due to the complexity of the commercial arrangements necessary for a viable business model."

Erosion of local incentives such as embedded benefits<sup>22</sup> and frequent changes to supplier compliance requirements has also meant that there has been very limited interest/take up of these arrangements.

### **e. White labels**

Any real moves to establish local supply involving community players have therefore tended to be through negotiated deals (often termed "white labels"). The white label provider is not licensed but it will have a contract with a licensed supplier that sets out the terms of the relationship between the two parties.

Ofgem introduced changes in the licensing regime in June 2015 to provide an enduring structure for such deals, which essentially introduced new Standard Licence Conditions on the licensed supplier regarding treatment of the white labels in the number of tariffs it can offer.<sup>23</sup> It also introduced a requirement that the marketing of the white label should be done by the unlicensed contracting party.

White labels can be used in conjunction with generation from community energy schemes. In practical terms this usually means a large supplier essentially "sleeves" local generation to local consumers supplied by the white label over the public network and then balances volumes through its own tariff. The supplier will price in the additional imbalance risk that it believes it is exposed to.

OVO Communities previously had several such arrangements.<sup>24</sup> However, as far as we are aware, only one supplier, Octopus Energy, is presently offering community or local deals of this sort. The main example is the contract with London Power, the GLA subsidiary which comprises a bespoke offer to regional communities.

Box 5 sets out further detail.

#### **Box 5 – White labels**

A white label is a business that does not have an energy supply licence but instead works in partnership with a licensed partner supplier to offer electricity and gas tariffs to customers. It is an option for both domestic and non-domestic energy supply, though there was particularly strong uptake for domestic supply offerings across 2017-2019.

White labelling is a less complex and less expensive way of entering the UK energy supply market when compared to going the full licensed route. It also allows for a smaller geographic area of coverage, such as limiting tariffs for specific postcodes or counties.

It has been used in various guises, ranging from supermarkets (Sainsbury's Energy) and retail (M&S) to council-led initiatives (Roar Power) and social impact enterprises (Ebico).

<sup>21</sup> [https://www.london.gov.uk/about-us/londonassembly/meetings/documents/s82520/Appendix%201a%20-%20Licence%20Lite%20Evaluation\\_Final\\_Redacted%20for%20publication.pdf](https://www.london.gov.uk/about-us/londonassembly/meetings/documents/s82520/Appendix%201a%20-%20Licence%20Lite%20Evaluation_Final_Redacted%20for%20publication.pdf)

<sup>22</sup> Embedded benefits are avoided costs determined by industry codes that allow a supplier to net off certain costs in respect of generation produced on the distribution system.

<sup>23</sup> <https://www.ofgem.gov.uk/publications/treatment-white-label-providers-domestic-retail-market>. These rules on the number of tariffs that can be offered have since been changed.

<sup>24</sup> Cheshire East, Peterborough, Southend and Plymouth are examples.

A white label arrangement can involve different levels of autonomy, starting from wholesale purchasing, settlement procedures and code compliance up to full end-to-end service. In the latter, the licensed supplier may also provide necessary Customer Relationship Management software, websites and help-centres on behalf of their white label client.

Deals of this kind are few and far between. They are entirely at the supplier's discretion and only one supplier is presently offering them. They usually concern existing assets and are not long-term. Community groups that I and Power for People have interviewed are also discouraged by the complexity and cost of negotiating and entering into non-standard agreements. They can also be expected to be tied into a balancing tariff with the supplier at terms which they have no control over.

## 6. Options for enhancing these arrangements

The above interventions demonstrate that both BEIS and Ofgem have been willing to intervene in energy market arrangements and regulation to support wider policy goals, address perceived distortions and clarify regulatory requirements on suppliers who, by virtue of their size, can act as the gateway to complex electricity markets.

We believe that within these examples referenced above there are potentially elements of comparable solutions that can achieve the goal of the Bill to support community energy and local supply. These would avoid undue distortion to the supply market that could create cost impacts for other customers.

We have identified two specific enhancements:

- A right to export community electricity on fair terms, and
- A right to require suppliers above a defined threshold to offer terms and "sleeve"<sup>25</sup> their power to local customers, while reflecting their agreed export price.

Both elements are needed to address the present barriers to enable fair market access and they should probably be combined from a legal and regulatory perspective.

Taken together, they would address the main defects in the current regulatory arrangements, namely:

- Absence of a guaranteed market for community energy
- No minimum price or revenue certainty, and
- A community energy provider would not want to become its own supplier under current regulatory rules even on a local basis. To supply to local consumers, community energy providers need a licensed supplier to be able to access metering registration and compliance services on their behalf.

Assuming the two mechanisms were combined, we call it the Community Electricity Export and Supplier Services Guarantee. Below, we explain how the two separate elements could operate.

### a. Community Electricity Export

This Guarantee would provide a clearer and more certain framework for communities to sell export power. It would close the anomalous gap relative to CfD holders whereby community producers are not guaranteed a route to market at a fair minimum price and have no contractual certainty over a minimum purchase period.

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<sup>25</sup> "Sleeving" electricity is where a supplier acts on behalf of a producer and a consumer to move power across the public system and deals with associated network costs and policy costs.

Conceptually, the mechanism could be similar to the OLR mechanism but for all electricity exports by community groups. It would be specified in secondary legislation and replace the SEG, and it would apply to community energy operators delivering power to the system through a smart meter and stipulate that eligible suppliers must offer terms and conditions for purchase in an approved form. The mechanism could be limited to community energy providers and potentially contain a capacity-based cap or caps applying to different technologies.<sup>26</sup>

The requirements would be underpinned by secondary legislation. The order could:

- Stipulate that the regulator must ensure eligible suppliers offer terms for, say, a 15-year period to all those who have signed up to the Community Electricity Export Guarantee
- Apply to suppliers with customer numbers above a specified threshold
- Require eligible suppliers to offer terms to purchase exports subject to a minimum price for a period of not less than 12 months
- Enable a participating community energy provider to opt to move to a competing (presumably better) deal as the market develops or enter the market directly if it should wish (although we think this unlikely), and
- Require Ofgem to produce an annual report to ministers on the operation of the mechanism (take up, tariffs, learnings etc.).

Symmetrical and amplifying arrangements would be specified in the supply licence. The supply licence could:

- Mandate specified suppliers with over 150,000 electricity customers to purchase exports and offer terms for balancing power
- Define the pricing mechanism (starting price and arrangements to vary according to RPI)
- Make clear that the participating community energy provider is not obligated to have a supply contract with the eligible supplier
- Allow other suppliers below the threshold to offer terms at their discretion
- Be based on standard terms and conditions set in the licence or alternatively within a framework approved by Ofgem, and
- Establish the reporting framework for eligible suppliers to report compliance annually and produce a public report on this.

#### **b. Supplier Services**

This proposed approach is designed to provide a framework that creates certainty around access to supplier services required under licence to enable self-produced power to be sold to and consumed by local customers and enforced under industry codes. It would take the mechanism underpinning licence-lite supply but be mandatory for eligible suppliers and would create a guaranteed route to customers for local community suppliers but without them being required to become licensed suppliers.

In effect, this would require eligible suppliers to “sleeve” power acquired from community energy providers under the Community Electricity Export arrangements at the negotiated rate to local customers. For ease, all other aspects of the community offer would reflect the suppliers comparable local tariff offering.

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<sup>26</sup> BEIS consulted on such an approach in its consultations on the SEG, eventually opting for 50KW for micro-CHP or 5MW for eligible renewable technologies.

Again, the mechanism would be specified in secondary legislation. It could be limited to community energy providers.<sup>27</sup>

The requirements would again be underpinned by secondary legislation, which would be combined with the provisions set out in the corresponding section on the Community Electricity Export arrangements. The order could:

- Stipulate that the regulator must ensure eligible suppliers offer terms for supplier services, say, a 15-year period to all those who have already signed up or intend to sign up to the Community Electricity Export arrangements
- Require eligible suppliers to offer terms for provision of services to community energy groups for the purpose of enabling them to make supplies to local customers based on their exports
- Make clear that the supplier services to the community energy provider must be reasonable
- Enable a participating community energy provider to opt to move to a competing (probably better) supplier deal as the market develops or enter the market directly if it should wish subject to obtaining its own supply licence (although we think this unlikely), and
- Require Ofgem to produce an annual report to ministers on the operation of the mechanism (take up, terms and service offerings, learnings etc.).

Symmetrical and amplifying arrangements would be specified in the supply licence. The supply licence could:

- Mandate specified suppliers with over 150,000 electricity customers to offer supplier services to community energy providers
- Require such suppliers to make a community offer reflecting the export price paid to the community energy provider (which might be higher or lower than the eligible supplier's electricity purchase costs)
- Require that the supplier makes the community offer available in all other respects on comparable terms to its own offers to local customers (think of this as a "green label")
- Require the eligible supplier to be the registrant for the meters of customers who sign up for the community energy offer and meet other compliance requirements provided for under the licence and industry codes with respect to the community energy provider's exports<sup>28</sup>
- Make clear that the participating community energy provider is not obligated to have a supply contract with the eligible supplier
- Allow other suppliers below the threshold to offer supplier service terms to the community energy provider at their discretion, and
- Establish the reporting framework for both eligible and voluntary suppliers to report compliance annually and produce an annual report.

### **c. Other possible measures**

We have also identified other areas in the market and regulatory arrangements that might provide options for supporting community energy without imposing costs on other customers,

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<sup>27</sup> This does not have to be the case, and it could be made available to local businesses.

<sup>28</sup> There would need to be a mechanism in the service agreement that allowed the supplier to recover its reasonable costs and allocate cost of any local distribution losses on the export volumes.

but we see these as additive to the core Guarantee proposal outlined in sections 6 (a) and 6 (b) above.

Other measures that could support community energy and might warrant consideration:

- A policy statement by the Government setting out its support for community energy and local supply
- A new obligation on suppliers to support community supply
- Further consideration of the licence exemptions regime, but this would need to be in conjunction with clarifying a duty on a licensed supplier to register the meter and charge reasonable costs<sup>29</sup>
- Access to CfD auctions for sub-5MW generation but only if they could be simplified for smaller applicants, including community energy groups<sup>30</sup>
- Some form of regional aggregation of community-based energy exports, potentially through the new Distribution System Operator structures through emerging flexibility tenders or alternatively seeding some form of trading platform operated by a licensed intermediary<sup>31</sup>
- Consideration of how local supply could support emerging local flexibility markets, including recognition that local supply from community energy assets may reduce some system costs
- Clarification of rules around ability to offer local tariffs, and
- Encouragement of Local Authorities and public sector bodies to buy from local community producers via sleeved (or "synthetic") PPAs where power moves across the public system, although this is reliant on establishing the guarantees set out above.

We also believe BEIS needs to take advice on current methodologies for calculating distribution losses (c. 5% of supply is lost during low voltage delivery), which are anachronistic, and these could be flexed so as not to penalise locally matched supplies.

**Nigel Cornwall**

**21 April 2022**

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<sup>29</sup> In practical terms, this would need to operate very much along similar lines to the proposals in this paper. However, given that sales to customers would occur other than through private networks, we assume that there would be regulatory preference to administer these arrangements in conjunction with current licence rules. As such, there would need to be a requirement on the licensed supplier to offer terms with some policy reassurance that the regime would remain in place for a minimum duration.

<sup>30</sup> If this were done, it would open-up arrangements for backstop PPA support to community energy developers. But application arrangements for CfDs are extremely complex and would deter applications from smaller schemes, and the institutional structure does not exist to allow disparate community groups to consolidate their output. Further thought might be given to institutional arrangements for aggregation and whether there might be a potential role for Distribution System Operators.

<sup>31</sup> This type of solution was implemented by DECC in the early days of Energy Company Obligation (ECO) for adoption to boost liquidity for ECO measures. The Non-Fossil Fuel Purchasing Agency/e-POWER also offers a commercial platform for FIT-eligible exports that have opted out of the FIT, but only suppliers can be the counterparty.