GREATER**LONDON**AUTHORITY

REQUEST FOR MAYORAL DECISION – MD2157

Title: Licence Lite

Executive Summary:

The Licence Lite project involves the GLA buying electricity from low to zero carbon electricity generators and selling it to TfL initially over a 12-month period as a pilot project. The project will provide a proof of concept of Licence Lite and will enable the delivery of the Mayor's manifesto commitment to 'buy clean energy generated across the city' and for London to be a zero-carbon city by 2050. The pilot is forecast to operate at a loss because of its initial small-scale operation and TfL's low electricity price. Following the 'proof of concept' pilot and further review by CIB, the longer-term objective would be to implement a viable five-year business plan, or other appropriate continuation project. The project has now reached the stage, whereby to begin operations the GLA must enter in the project agreements which have been negotiated.

To enable this the decision to exempt Cornwall Energy and Arup from the GLA procurement code has been requested because of their specialisms in energy markets and processes and their knowledge of the project having supported its development up to this stage. This request for a Mayoral Decision is to authorise the GLA making a binding commitment to the 12-month pilot project, by means of granting the approvals set out below.

Decision:

That the Mayor approves:

1. A 12-month pilot scheme for the Licence Lite Project, which includes the GLA being granted an electricity supply licence by the Ofgem and entering into contracts;
2. Expenditure of up to £498,000;
3. A related exemption, regarding the entry into contracts with Cornwall Energy and Arup, from the requirement of the GLA's Contracts and Funding Code that such services be procured competitively;
4. Procurement of the Operating Services by means of competitive tender;
5. The receipt of income of £336,000 from TfL and from the sale of the surplus electricity under the agreement with RWE nPower; and
6. A direction to TfL so that TfL can enter into the 12-month supply arrangements contemplated as part of the pilot, as attached at Annex 2 and issued pursuant to section 155(1)(c) of the GLA Act 1999.

Mayor of London

I confirm that I do not have any disclosable pecuniary interests in the proposed decision, and take the decision in compliance with the Code of Conduct for elected Members of the Authority.

The above request has my approval.

Signature: **Date:** 24/8/17

PART I - NON-CONFIDENTIAL FACTS AND ADVICE TO THE MAYOR

Decision required – supporting report

1 Introduction and background

1.1 The Mayor's manifesto commitment pledged to 'buy clean energy generated across the city, using it to power GLA and TfL facilities'. Licence Lite will fulfil this commitment by enabling the GLA to purchase electricity generated from smaller, low and zero carbon electricity generators and sell it to GLA group members and public sector organisations to use in their buildings. The GLA has been negotiating with TfL to be the first consumer.

1.2 Licence Lite has been promoted by Ofgem since 2011 as a new licencing arrangement and is designed to provide smaller scale generators of low and zero carbon electricity generation with a better route to the electricity market, to enable them to enhance their electricity revenues and attract more investment in low and zero carbon energy systems. As such it is a key component 'Energy for Londoners' the Mayor's flagship programme which comprises all work on energy efficiency, supply and fuel poverty support. The GLA is the first body in the country to apply for the licence and develop an operating project.

1.3 Licence Lite has been a long-standing GLA commitment to remove market barriers holding back the investment in decentralised energy, a key technology in combating climate change that reduces emissions of the greenhouse gas carbon dioxide. The GLA has applied to Ofgem for a Licence Lite electricity supply licence to enable the Authority to purchase the output of smaller, clean electricity generators and sell it to electricity consumers.

1.4 The Licence Lite project will transform the way we promote local energy to deliver a zero-carbon city. It will offer generators a better price than the alternative of selling their surplus electricity to the 'big six'. The GLA has led the development of this complex concept that will help diversify city energy sourcing towards a local low carbon supply.

1.5 The Mayor's support for Licence Lite will stimulate investment in decentralised energy that will contribute towards London being a zero-carbon city by 2050. It will do this by helping stimulate and develop affordably priced markets for locally generated electricity.

1.6 The Licence Lite project, is linked with the Mayor's Decentralised Energy Enabling Project (DEEP) that provides public sector intervention to help others realise larger scale DE projects that the market is failing to deliver: Licence Lite will enable DE schemes to obtain better value from the electricity they export and will support Mayoral solar electricity and community energy initiatives.

1.7 The GLA's application to Ofgem for a Licence Lite licence was approved by DD897, and varied by DD1416 and the draft business plan and financial model was approved by MD1663, on the basis that a further Mayoral approval would be obtained before any commitment to supply electricity is made.

1.8 The Mayor wishes to bring the project into operation as a 12-month pilot project to establish the trading arrangements and processes. The Mayor will evaluate the success of the initial Licence Lite pilot project and consider whether to implement a viable five-year business plan or other arrangement that would sign-up other GLA group members and public sector organisations to purchase local low carbon electricity.

1.9 The success of the project will be evaluated against the forecast project costs, income and CO_2 savings. The financial evaluation will confirm:

- o Whether the proposed team is the right size and structure to carry out the management of the day-to-day energy market processes, pay the generators and bill TfL, and that;
- o The generator supply and TfL demand can be managed to equal or better the forecast 12-month operating margin of -£95,000.

1.10 Under the Licence Lite business model and regulatory system, the GLA as a holder of the Licence Lite is relieved of its obligation as a licensed supplier to be a party to the principal industry codes and avoids certain cost risks and complexities of being a party, in return for reaching an agreement with a licensed supplier who is a party to the codes and provides the necessary market interface services. The arrangement is known as the Supplier Service Netting Off Agreement (SSNOA).

1.11 The SSNOA will allow the GLA to purchase the output from low and zero carbon electricity generators and supply the electricity produced to public sector and commercial electricity consumers. The SSNOA also provides 'balancing' services in that it provides electricity from the market to meet the consumer's electricity demand during those times the generation is insufficient (top-up), and to sell to the market electricity generated that is in excess of the consumer's demand (spill).

1.12 The GLA will buy electricity from low and zero carbon electricity generators under a Power Purchase Agreement (PPA), and supply it to selected public sector and commercial consumers under a Supply Agreement (SA). The model is low cost and low risk compared with current mainstream electricity supply activities and offers to small scale low and zero carbon electricity generators a better route to market enabling them to attract more investment.

1.13 The risks to the GLA have been addressed in the Legal Report and Risk Matrix (Part 2, Annex 3). The key points to note are that:

- o The SSNOA ensures that TfL always receives the electricity it requires in the event of a generator failure by purchasing and supplying electricity from the market;
- o The maximum commercial liability of GLA being exposed up to the limit of liability under all agreements is £400,000. This is based on the SSNOA, two PPAs and one SA. The likelihood of such a scenario is extremely low.

1.14 The Licence Lite project is now ready to be completed and begin operations for a 12-month pilot, the next step being the approval of the business plan and financial model, the internal management and governance arrangements and signature to contracts with the counterparties to the project, so that the Licence Lite project can commit to supply operations.

1.15 Section 7 below sets out future action and timing, the objective being that subject to Mayoral approval, the GLA can commence Licence Lite operations by 1st October 2017. This Mayoral Decision is to enable the GLA to commence Licence Lite operations, by approval of:

1.15.1 A 12-month pilot scheme for the Licence Lite Project, which includes the GLA being granted an electricity supply licence by the Ofgem and entering into contracts with:

- Peabody Trust – electricity generator PPA
- Scottish and Southern Energy – electricity generator PPA
- Transport for London – electricity consumer SA
- RWE nPower – third party supply licenced supplier agreement
- Office of Gas and Electricity Markets

1.15.2 Expenditure of up to £498,000 which includes:

- The costs associated with the purchase of generated electricity, its onwards supply and top-up of its shortfall: £351,000
- Operating Services: £80,000
- External specialists, legal advice (Lux Nova): up to £15,000
- Energy markets consultancy (Cornwall Energy): up to £2000
- Business planning and operational processes set-up (Arup): up to £30,000
- GLA 0.2 post at a grade 14 of £20,000

1.15.3 A related exemption, regarding the entry into contracts with Cornwall Energy and Arup, from the requirement of the GLA's Contracts and Funding Code that such services be procured competitively;

1.15.4 Procurement of the Operating Services by means of competitive tender;

1.15.5 The receipt of income of £336,000 from TfL and from the sale of the surplus electricity under the agreement with RWE nPower; and

1.15.6 A direction to TfL so that TfL can enter into the 12-month supply arrangements contemplated as part of the pilot, as attached at Annex 2 and issued pursuant to section 155(1)(c) of the GLA Act 1999.

2 Objectives and expected outcomes

2.1 Licence Lite has the potential to benefit both public and private sector groups that have an interest in delivering low and zero carbon decentralised energy schemes, through enhancing their prospective revenue streams from electricity generation. As described in section 7.2 below, the five-year business plan illustrates the possible revenue enhancement of the Licence Lite operation and its financial margins that have the potential to grow as the Licence Lite operation expands and is able to share its overheads more widely.

2.2 The Licence Lite 12-month pilot project demonstrates that on current and forecast electricity prices, the GLA as an electricity supplier has the longer-term potential offer to low and zero carbon smaller scale electricity generators (often referred to as decentralised energy 'DE' schemes) of better prices for their electricity generation. These generators do however have to offer the GLA best market value through participating in a competitive procurement procedure that has been completed.

2.3 Considering the strong negotiating leverage of TfL as a bulk purchaser of electricity and its forward purchasing strategy, matching TfL's current pricing means that during the 12-month pilot period of the project, the GLA will be supplying TfL at their current price which is lower than the typical average market rates. Discussion with other public sector and commercial consumers in London with less electricity demand, less negotiating leverage or alternatively a different purchasing strategy, indicates that their current electricity costs better reflect average market rates and offer the potential for improved margins for the Licence Lite operation.

2.4 The GLA's Licence Lite model can also offer a tolling or 'shipping' arrangement to the likes of councils to self-supply with low and zero carbon electricity which they generate themselves or purchase from other sources of low and zero carbon electricity. The generation purchase prices can represent an appreciable uplift to DE schemes in London and at the same time lower the borough's electricity bills for the premises selected for supply. This aspect does not form part of the 12-month pilot project but would be explored as part of the five-year business plan that would be the subject of a further MD.

2.5 Subject to further procurement, the Licence Lite model offers the opportunity to support local community green energy schemes by enabling the schemes to deploy their output from local electricity generating plants to supply power to public bodies and businesses with an interest in the scheme. This MD includes the supply of energy purchased from solar energy schemes: the five-year business plan will consider the supply to councils which own the schemes with the electricity they produce, thus improving the prospects of new solar schemes reaching financial viability following the reduction of government support.

2.6 GLA economics estimate that the availability of Licence Lite as a route to market for DE generators could bring forward in excess of an estimated £300 million of additional investment by 2020. By that date, this has the potential to create an estimated 1,650 short term construction jobs and 160 permanent jobs in operating the energy centres and networks; and thereafter larger amounts of investment and numbers of jobs as the potential for DE in London is realised.

2.7 The GLA is taking a lead with Ofgem in developing the Licence Lite business model and the regulatory regime that supports it. When the Licence Lite operation is up and running, the Mayor will be able to lead on introducing the model to other local authorities and also community groups who are watching the development of Licence Lite in anticipation of an industry business model and regulatory regime arising out of it which they can follow.

3 Equality comments

3.1 Gender Equality and Equal Opportunities are enshrined within the GLA's programmes and activities according to the Mayor's Framework for Equal Life Chances (June 2014). The framework aims to bring Londoners together rather than dividing them. It promotes outcomes for a diverse range of communities that seek to bring real changes to the quality of life for all Londoners. The Licence Lite project is dedicated to securing the growth of decentralised energy, along with energy efficiency and falls within the framework's Environment Objective 1.2. The objective seeks to ensure protected groups such as old and young people and those who are vulnerable are better able to afford clean domestic energy. DE specifically aims to help others develop and deliver energy supply projects that will reduce Londoners' energy costs by up to 10 per cent on their current bills.

3.2 Accessibility for those with disabilities applies to those organisations the GLA has (or will) appoint to provide specialist support services or as counterparties in purchasing or supplying energy, pursuant to the public procurement processes already undertaken, through the organisations concerned having had to pre-qualify and complete and pass an equalities questionnaire as part of the evaluation process. The questionnaire determines the level of disability provision provided by the organisations for its employees and visitors and fails those who do not meet the minimum requirements.

4 Other Considerations

4.1 Other considerations relate to links to the Mayor's strategies and priorities, described below.

4.2 The pilot project will provide a proof of concept of Licence Lite and will enable the delivery of the Mayor's manifesto commitment to 'buy clean energy generated across the city' and for London to be a zero-carbon city by 2050. As such it forms a key part of Energy for Londoners and the London Environment Strategy. The Licence Lite project is linked with the Decentralised Energy Enabling Project (DEEP). This is a programme which runs from April 2016 to September 2019 providing public sector intervention to help others realise larger scale DE projects that the market is failing to deliver. Licence Lite will directly contribute to this project by providing DE schemes with an alternative route to market, with the potential to enable DE schemes to obtain better value from the electricity they export.

4.3 The project will support Mayoral solar electricity and community energy initiatives.

5 Financial comments

5.1 Mayoral approval is being sought for expenditure of up to £498,000 for the 12-month pilot operation of Licence Lite. The costs comprise of £478,000 in project costs and a 0.2 FTE post at a grade 14 of £20,000. In addition, this decision is seeking the receipt of income from TfL totalling £336,000. The total budget requirement is £162,000.

5.2 The proposed revenue expenditure of £162,000 is to be funded from the capital budget of £6.5m for Energy Efficiency which will be funded via a capital / revenue swap of GLA budget resource.

6 Legal comments

6.1 As regards the powers of the GLA:

6.1.1 The GLA has powers under the Greater London Authority Act 1998 ("GLA Act") (section 30) to promote the improvement of the environment in Greater London, in doing which it is to have regard to the achievement of sustainable development in the UK, and to climate change, and the consequences of climate change. Further, the GLA has an obligation (under section 361A of the GLA Act) to address climate change, so far as relating to Greater London. Under section 34 of the GLA Act, the GLA may do anything calculated to facilitate, or conducive or incidental to, its functions.

6.1.2 Provided that implementation of the Licence Lite proposals will help to improve the environment in Greater London, having regard to the achievement of sustainable development in the UK, and/or to address climate change in Greater London, and/or will facilitate, conduce or be incidental to, such matters, the proposals are within the GLA's powers. Notwithstanding the power under the prospective licence to supply premises throughout Great Britain, the GLA will need to bear in mind the geographical constraints on its powers.

6.1.3 It is understood that at present what is proposed is purely a pilot scheme, and it is not expected that any surplus will be made. In piloting this scheme, the GLA does not appear to be exercising its powers for a commercial purpose.

6.1.4 Should the pilot scheme be successful, and should it be contemplated that the scheme will move towards a full scale, enduring, operational scheme, with a view to profit, then the further legal considerations set out in the following paragraphs (which are not exhaustive) will apply.

6.1.5 It is noted above that the GLA plans to sell electricity at market rates. Under section 95 of the Local Government Act 2003, and the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009, the GLA has power to do for a commercial purpose anything which it is authorised to do for the purpose of carrying on any of its ordinary functions.

6.1.6 Under s95(4) of the 2003 Act the GLA must exercise its powers to do things for a commercial purpose through a company.

6.1.7 Under article 2(2) of the 2009 Order, the GLA must prepare and approve a business case, defined as "a comprehensive statement as to—
(a) the objectives of the business,
(b) the investment and other resources required to achieve those objectives,
(c) any risks the business might face and how significant these risks are, and
(d) the expected financial results of the business, together with any other relevant outcomes that the business is expected to achieve".

6.1.8 Specialist external legal and regulatory advice has been provided on the arrangements. Further legal input would be required should the pilot move beyond the initial stage. An overview of the arrangements and legal risks and issues are contained in the risk matrix attached as Part 2, Annex 3. This paragraph contains an overview of them. An overview of financial risks and issues arising out of the financial model are contained in paragraph 4 above (Financial Model). The legal risks and issues are divided into two categories: risks and issues arising out of the project agreements to which the GLA will be a party, and risks and issues which arise as a result of the GLA's obligations under the electricity supply licence which would be granted to it under the 'Licence Lite' regime.

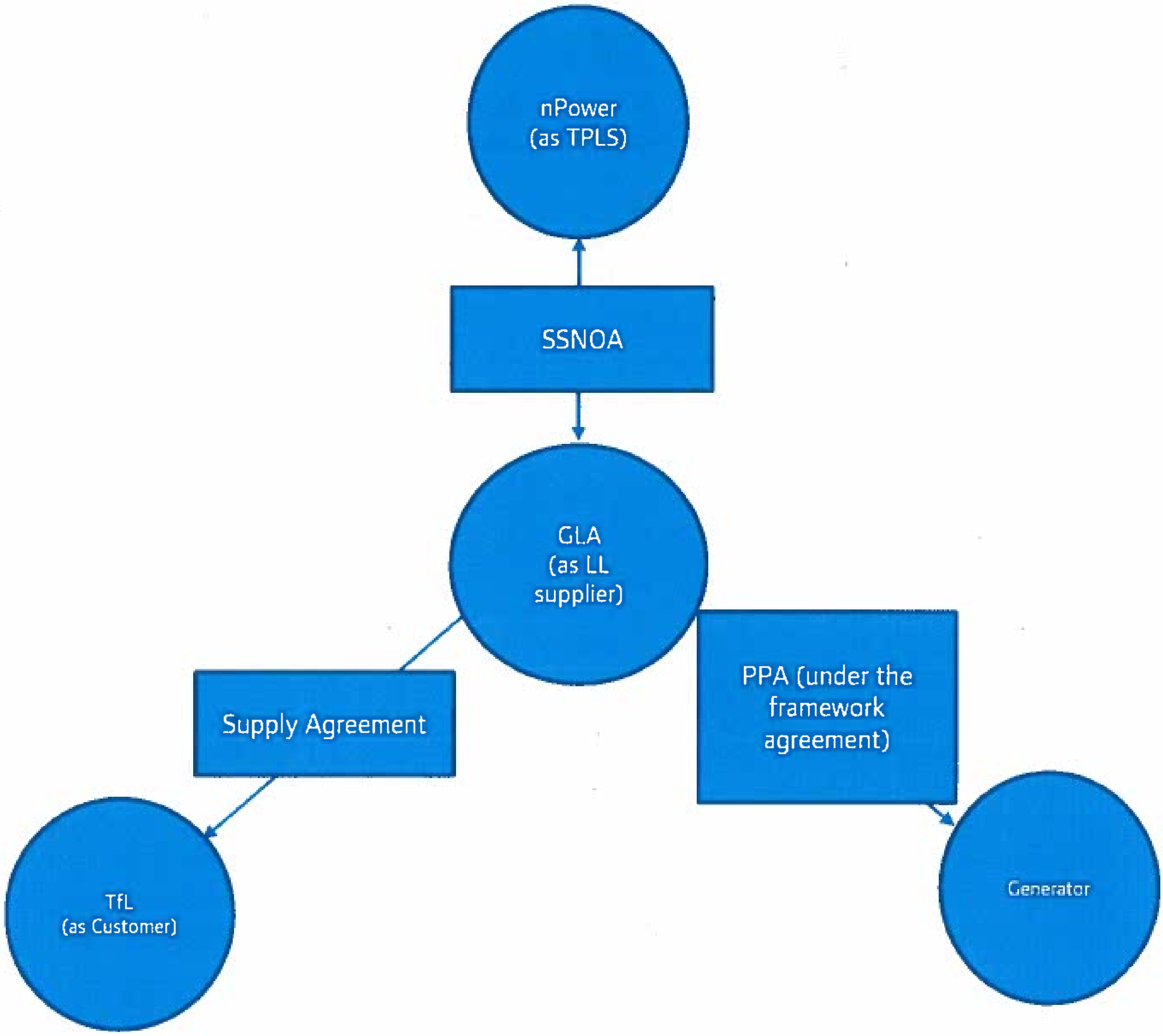
6.2 The project agreements to which the GLA would be a party for the pilot are:

6.2.1 The Supplier Services and Netting Off Agreement between the GLA and a fully licensed electricity supplier (RWE npower);

6.2.2 The Framework Agreements already entered into between the GLA and a number of the low carbon electricity generators. This sets out the basis for mini-competitions to be run under the framework process and a pre-agreed form of call-off Power Purchase Agreements to be entered where the GLA accepts generator's commercial offers. Under these PPAs, generators would be providing the GLA with its wholesale electricity supplies for it to supply to its electricity customers. Following such a mini-competition, commercial offers from two generators have been accepted (in principle), following selection from a panel of generators which has been procured under a competitive tender arrangement;

6.2.3 The GLA's Electricity Supply Agreement with TfL (TfL being the GLA's first electricity customer), under which the GLA supplies to TfL the electricity it has purchased from the generators.

6.3 The relationship between these agreements is illustrated in the following diagram:



6.4 The Supplier Services and Netting Off Agreement (SSNOA) is central to the 'Licence Lite' regime, because it allows derogation from a very important and onerous requirement placed on electricity supply licence holders in Ofgem's standard electricity supply licence terms which, without the derogation, would be imposed on the GLA as a licence holder. This licence condition (Condition 11.2) requires participation by every licensed supplier in a complex suite of intra-industry agreements and codes, involving costs, risks and complexities which it would be very unsuitable for the GLA to undertake itself, in a simple electricity supply arrangement available under the 'Licence Lite' model. The SSNOA is a new form of agreement for the electricity industry and must be approved by Ofgem. The SSNOA therefore:

6.4.1 Secures (through RWE npower who would be the counterparty to the SSNOA) for the GLA the services it needs to qualify for the derogation from standard licence condition 11.2 and, therefore, from the need to enter into the complex and risk related industry codes and agreements referred to above;

6.4.2 Enables the GLA to be provided with the 'top up' electricity supplies it needs, since there may be times when the generators contracted to the GLA under their Power Purchase Agreements are unable to provide all the electricity needed by the GLA's customers; or, alternatively, the SSNOA enables the GLA to dispose of 'spill' – an excess of electricity produced by the generators over the quantity consumed by the GLA's customers, at any particular time;

6.4.3 Deals with the GLA's short term 'imbalance' requirements. This arises when the need for top up or spill arises at very short notice, giving rise to an 'imbalance' under the market rules. The SSNOA contains arrangements to enable that to be managed.

6.5 There are key legal risks associated with the SSNOA, the principal risks being costs or losses arising from its early termination in some circumstances. As described above (see paragraph 7 below Exit Strategy), the SSNOA is designed to be terminated early if the GLA wished to exit from Licence Lite. Providing the GLA does so at the same time as it allows the Power Purchase Agreements with its generators and the Supply Agreements with its customers to expire, the GLA need not suffer any penalty. As can be seen from the risk matrix, early termination outside a pre-planned exit strategy is an unlikely event, but if it occurs can give rise to substantial risk of additional costs or losses. The reasons for early termination would probably be as result of RWE npower's serious default under the SSNOA, giving rise to termination, or the GLA's serious default under the SSNOA. There are limitation of liability provisions benefitting both the GLA and RWE npower under the SSNOA, but there are situations where these provisions will not apply to all the loss that could be incurred.

6.6 To minimise the GLA's potential exposure, termination of the SSNOA automatically triggers termination of all the Power Purchase Agreements with generators and the Supply Agreements with customers to avoid the GLA breaking the laws relating to electricity supply. In scenarios such as these, where termination of a Power Purchase Agreement or Supply Agreement by the GLA is not brought about by generator or customer default, these agreements provide that the GLA must pay compensation. This is 'market standard' and the amount of compensation depends upon a number of factors (primarily to do with closing market positions) but is subject to the overall cap on the GLA's liability under each agreement. If the SSNOA were to be terminated by RWE npower because of the GLA's default, the GLA could be liable to pay compensation on termination of that agreement too, subject to the GLA's overall cap on its liability under the SSNOA. This would be in addition to compensation payable under the power purchase and electricity supply agreements.

6.7 There are very few things that the GLA could do that would give rise to a termination right exercisable under the SSNOA against the GLA. All are obligations within the control of the GLA to comply with and to remedy if it did slip into default. Prolonged non-payment by the GLA would be the most obvious (but also the most unlikely and easily avoided) trigger for termination against the GLA. On the other hand, if the SSNOA was terminated by the GLA because of default by RWE npower (also unlikely), the GLA has a right to recover from RWE npower any compensation that the GLA is liable to pay under the Power Purchase Agreements and /or Supply Agreements, subject to the limit on RWE npower's liability under the SSNOA.

6.8 In a worst-case scenario, during the pilot phase, if the GLA faced liability up to the limit under each of the SSNOA, the two PPAs and the Supply Agreement concurrently, it could face £400,000 liability. However, this is only a theoretical exposure. The GLA would only face that level of exposure if it committed separate breaches under each of the agreements - not caused or contributed to by any of the other parties. Consequently, breach by the GLA of one agreement is more likely to be caused (or, at least, contributed to) by breach by a party to one of the other agreements provided the GLA is acting competently. As such, where the GLA is liable under one agreement, it is reasonably likely that its exposure will be offset to some degree at least by a claim against a party under one of the other agreements. Importantly, the GLA will have the ability to manage breaches and potential breaches under the PPA and Supply Agreement, in particular, before they become breaches of the SSNOA. It should ensure that it has effective contract management systems in place.

6.9 This worst-case exposure does not include liabilities that the law says cannot be limited but, in the absence of fraud, these are generally liabilities that are insurable. Nor does this maximum exposure include market compensation risk under the SSNOA but the GLA can avoid this risk by instructing nPower not to purchase electricity on its behalf on any basis giving rise to any such market exposure risk beyond the pilot phase.

6.10 Change of law provisions in the SSNOA pass most risk arising from changes to industry rules and charges to the GLA. However, as is standard practice, the terms of the Power Purchase Agreements and the Supply Agreement back this risk off by passing all such risk to generators and customers.

6.11 There are provisions enabling the GLA to recover losses from other parties under the Power Purchase Agreements and Supply Agreements if the GLA breaks an obligation under the SSNOA as a result of their conduct. Notably, the GLA indemnifies RWE npower under the SSNOA in respect of losses and liabilities resulting from regulatory breach caused by the GLA's default under the SSNOA. To the extent that this is caused by either a generator under a Power Purchase Agreement or a customer under a Supply Agreement, the GLA will be able to bring a claim against the generator or customer, as applicable. The GLA gives no indemnities under the Power Purchase Agreement or Supply Agreements.

6.12 The limits on liability under the SSNOA are as set out in the risk matrix in Part 2, Annex 3.

6.13 The Power Purchase Agreements and the Supply Agreement with TfL will be entered into for a period set to expire after one year (or may be subject to renewal). This avoids the risk of the GLA either: (a) having customer(s) but not generating capacity; or (b) having generating capacity but no customer(s) to whom to sell the electricity it is obliged to purchase. This means that the GLA is able to avoid taking on additional risk by running its 12-month pilot.

6.14 A number of provisions have been broadly aligned across the SSNOA and the Power Purchase Agreement and Supply Agreement, including: metering provisions, payment provisions, force majeure provisions, termination rights and notice periods and dispute resolution provisions. This reduces the risk of liability gaps arising.

6.15 The limits on liability under the Power Purchase Agreement and Supply Agreement are as set out in the risk matrix in Part 2, Annex 3. There is a slight asymmetry between the limits of liability in the form of Supply Agreement and the Power Purchase Agreements, but to align them fully would mean being out of line with market practice.

6.16 Generally, the form of each of the Power Purchase Agreement and Supply Agreement adopts content, wording and risk allocation from equivalent agreements commonly in use in the market place. In the allocation of risks between the counterparties, therefore, there is consistency with what would be considered normal 'market practice'. This is important, strategically. Following market terms means that the form of these agreements would not be a bar to scaling up the Licence Lite business. That is important because scaling can mean building and broadening the GLA's portfolio of generators selling it electricity and growing and broadening its portfolio of customers buying electricity from it. That should enable the GLA to spread and mitigate risk and to operate at higher volumes with better margins.

6.17 Each of the SSNOA, PPA and Supply Agreement were subject of an independent Commercial Due Diligence Report (see Annex 1). It contained a number of observations relating to alignment of certain provisions in the contracts. The provisions referred to have been brought further into alignment where appropriate. Recognising the need to maintain industry standard risk allocation, to enable later scaling, a degree of asymmetry remains.

6.18 Part 2, Annex 3 contains a report providing a high-level description and summary of each of the agreements referred to above, noting (as applicable) where obligations borne by the GLA flow down to other parties. It also contains a risk matrix, highlighting the key risks across these agreements and comments on how they are mitigated.

6.19 The GLA's status as a holder of an electricity supply licence also gives rise to risks and issues relating to legal liability. The key legal risks and issues are set out in the risk matrix attached as Part 2, Annex 3. The legal risks and issues are divided into two categories: the need to hold a licence in order to carry on an electricity supply business, and obligations imposed as a condition of holding such a licence.

6.20 The Electricity Act 1989 requires that anyone supplying electricity to customers' needs either to hold and comply with the terms of a supply licence granted under the Act or to benefit from an exemption from the requirement to hold a licence. The Licence Lite business model is predicated on it holding a supply licence, so none of the exemptions are relevant and it will not operate unless and until it has a licence. However, should the GLA lose its licence, it cannot continue to operate that electricity supply business without falling foul of the Act. As described above, in section 6.4, one possible trigger for the GLA losing its licence would be if the SSNOA was terminated or expired and not replaced. The risk of this happening and how this is mitigated is discussed above.

6.21 As a licensed supplier of electricity, the GLA will have to comply with the terms of its licence. Although under the Licence Lite derogation, the GLA will not have to comply itself with standard licence condition 11.2 (doing this through TPLS under the SSNOA), it must still comply with every other licence condition. For so long as the GLA is not providing supply to domestic customers, many of the other, more onerous standard licence conditions do not apply. Those that do apply include accounting for various levies imposed on electricity suppliers (such as the climate change levy, renewables obligation levy, contract for difference levy, etc). It also includes treating customers fairly and keeping its terms of supply (Supply Agreement) up-to-date and compliant with law. A summary of the obligations that will apply is also set out in Part 2, Annex 3.

7 Planned delivery approach and next steps

7.1 12-month Pilot Project Plan

7.1.1 This section sets out the Licence Lite 12-month pilot project and is the subject of this MD.

7.1.2 The objective of the GLA's Licence Lite is to provide smaller generators better access to the electricity market by matching, as far as possible, the output of the generators with the consumption requirements of specific consumers. This is carried out by giving the generators local market 'signals' as to the best time for them to generate in order to earn them most income relative to their costs. The effect is that the supplier (the GLA), who buys the electricity from the generators, needs to buy less more expensive electricity from the wholesale market or has less excess electricity to dispose of at uneconomically low prices, a saving that the generators can share in.

7.1.3 During the first pilot year, supply operations will be confined to a single electricity consumer, TfL.

7.1.4 The first 12 months of operation will be carried as a pilot project and the operation is forecast to run as a loss-making, small-scale project to prove the concept at low financial risk to the GLA and TfL as the buyer of electricity. The initial turnover is forecast to make a £95,000 loss based on buying an estimated generation of 4,000 megawatt-hours per year, with an approximate annualised supply revenue of £336,000.

7.1.5 The Licence Lite business model involves commercial and legally binding contract relationships with three types of contractual arrangement, in addition to the licence:

7.1.6 RWE nPower as the fully licensed third party supplier: this will involve the GLA purchasing the necessary electricity market interface services, the top-up electricity required from the wholesale market and the disposal of electricity which the GLA has surplus to its requirements. RWE npower's functions do not involve the interface with consumers. Their role is technical and they neither supply nor invoice the GLA's customers;

7.1.7 Electricity generators: the GLA will purchase electricity from the generators under a Power Supply Agreement (PPA) that it requires to supply its customers. There is a separate contract with each generator, but it is a standard form developed by the GLA, subject only to variations which reflect factors individual to each generator, notably the pricing arrangements set by competitive tenders;

7.1.8 Electricity consumers to whom the GLA supplies electricity under a Supply Agreement (SA), initially TfL. A separate supply contract is entered with each supply customer, in a standard form, subject to requirements specific to that customer.

7.1.9 The basic viability of the Licence Lite project depends upon it maintaining a margin between the wholesale cost of the electricity purchased from the generators and the price paid by TfL and other consumers. The prices in both cases are for the same fixed periods and therefore avoid the exposure to the risk of either price becoming out of step with the other during the period. The prices agreed with the generators and TfL reflect these 'back to back' pricing arrangements.

7.1.10 The capital requirements are limited, mainly because the complex and expensive market interface processes (data for consumption flows, market balancing and settlement requirements, invoicing etc.) are managed by RWE npower, the GLA being charged a fee. This confines capital requirements to a computer terminal and software compatible with RWE npower's software. The planned timing of invoicing and payment is designed to minimise working capital requirements.

7.1.11 The Licence Lite staff skills require a good overall knowledge of the electricity market systems and generation technology but no specialised knowledge since the complex market administration requirements are undertaken by RWE nPower. Resource requirements during the first 12 months of operations are set out below:

- Project Manager, allocated from existing GLA resource: 8 hours per week
- Operating services, to be procured from the market: 20 hours per week
- Data collection and invoicing, from GLA support services: 8 hours per week

7.1.12 The day-to-day operation of the Licence Lite project is structured by the Operating Protocol agreed between RWE nPower (the provider of market interface services) and the GLA Internal Operating Manual. The Operating Protocol deals with the processes for the registration of the electricity meters being supplied by the GLA, collection of metering data, invoicing as between RWE nPower and the GLA, reporting on relevant invoicing, consumption and other information relating to each GLA customer, reporting on compliance with those industry codes where compliance is dependent upon action or information by or from the GLA, transfer of customers to and from the GLA and related matters.

7.1.13 The Operating Manual is the GLA's own manual for managing all the processes relating to operating Licence Lite for which the GLA is responsible. This includes obtaining information required of the generators concerning their forecast generating times and other matters, invoicing processes for invoicing the GLA's customers and receiving, verifying and making payment of invoices from generators and financial and management reporting.

7.2 Five-year Business Plan

7.2.1 This section sets out the Licence Lite aspiration to continue the project by implementing a five-year business plan subject to the 12-month pilot project being a success, and the review by CIB.

7.2.2 The development of the five-year plan would commence during the first 12 months of the pilot project. The 12-month pilot project would form year one of the five-year plan and would aim to continue the Licence Lite operation without interruption.

7.2.3 A viable business plan is possible over a five-year period provided more generation capacity contracted and a proportion of the electricity sold is done so at a higher price than the 12-month pilot project. This is based on one of the framework generators having declared itself available from April 2018 and other GLA Group bodies that buy their electricity at higher prices than TfL.

7.2.4 The five-year business plan revenue is forecast to increase with the acquisition of more generation capacity to estimated generation of 13,600 megawatt-hours hours per year with an approximate annualised revenue of £1,200,000. Along with 20% higher-paying consumers, the annual cash-flow is forecast to be positive.

7.2.5 Licence Lite could also offer a bespoke service to London boroughs which operate their own DE generating capacity by using its ability as a licensed supplier to 'ship' the council's electricity output to its own sites (for example Council offices, schools, sports centres and other premises) where the Council itself can use its own power. The GLA is currently discussing such an arrangement with three councils for future supply arrangements.

7.2.6 As Licence Lite grows, the framework of generators could be retendered to increase their number and capacity of the generating plants from year two. The retendered frame is expected to include larger waste to energy plants.

7.3 Procurement

7.3.1 Two procurements have taken place:

7.3.1.1 The procurement of the Electricity Market Services under OJEU 2014-000024 for the third-party licence services provider that was awarded to RWE nPower for a five-year contract. The initial obligations are for a 12-month period;

7.3.1.2 The generator framework for the Provision of Licence Lite Generating Capacity under OJEU 2015/S 094-171324 that was awarded to six generators. An OJEU procurement was necessary to ensure Licence Lite can sell electricity to those subject to procurement regulations for their energy purchases. A mini-competition, reference GLA 80630, was subsequently carried out to purchase 12-months of generating output starting 1st October 2017 that resulted in the award to two generators: Scottish and Southern Electricity, for the output from their gas-fired combined heat and power plant, and Peabody Trust, for the output from their photovoltaic installation.

7.3.2 The 12-month Supply Agreement with TfL as the electricity purchaser, has been largely negotiated is subject to agreement on the final prices. The proposal is to supply electricity to their Northfields and Northumberland depots. TfL require confirmation from Licence Lite before 1st September 2017 that they will commence the supply of electricity for a 12-month period from 1st October 2017. This is the notice period required to inform their existing electricity supplier that they will be removing the depot meters from their current supply arrangements.

7.4 12-month Project Revenues

7.4.1 The income and expenditure for the 12-month pilot project are set out in Table 1 below. They comprise income from electricity sales to TfL and from the sale of the surplus electricity (Spill) under the RWE nPower agreement. The costs include buying electricity from the generators and from the market (top-up), the RWE nPower costs and fixed operating costs. These costs are a mixture of fixed and variable costs. The development costs to prepare the project for operation are set out below:

Table 1 12-Month Income and Expenditure

	£k
Development and Mobilisation Costs to 30 September 2017	
Professional fees (Cornwall Energy)	2
Legal fees (Lux Nova)	15
Business plan and process set-up (Arup)	30
Total costs	**47**
Operational Revenues 1 Oct 17 - 30 Sept 18	
Operational Income	
TfL Supply	300
Spill revenue	36
Total income	**336**
Operational Expenditure	
SSE generation procurement	155
Peabody generation procurement	16
RWE nPower (Management Fee & Top Up)	44
Regulatory & compliance related costs	136
Operational services	80
GLA Manager	20
Total expenditure	**451**
Net Project Cost	**162**

7.4.2 Based on the results of the mini-competition with the framework generators and without contracting for any additional generation, the 12-month project will incur an operational loss of £95,000 (ie £431k - £336k). This is caused by insufficient generation to spread the fixed operating costs and too low a selling price to TfL. Combined with the pre-operational development costs to finalise the agreements and the setting-up costs of £47,000, and the provision of 0.2 GLA officer grade 14 at £20,000, the net costs of the 12-month project will be £162,000.

7.5 12-Month Pilot Project exit strategy

7.5.1 The contingency of the Licence Lite project not meeting expectations of future potential in terms of procuring more generation and higher-paying consumers being the subject of a future MD during its pilot period has been addressed.

7.5.2 None of the electricity purchase arrangements with the generators nor electricity consumers will be in excess of 12 months. The Mayor is at liberty not to renew them after expiry.

7.5.3 The proposed agreement with RWE nPower for market interface services can be brought to an end by the GLA in the event that the GLA ceases its electricity supply activities. 5 years from the Commencement Date, unless terminated by GLA exiting Licence Lite, that can be done on not less than 3 months' notice

7.5.3.1 The electricity supply licence granted by Ofgem can be surrendered.

7.6 Due diligence and verification

7.6.1 The GLA commissioned an independent Commercial Due Diligence Report (October 2016, Executive Summary, Annex 1). The report does not displace any of the material assumptions of the Licence Lite business model or financial model, but introduced some issues regarding the formulation of the contracts and the financial model which have been taken account of.

7.6.2 The report recommended a full audit of the financial model. This is not deemed necessary for the 12-month pilot stage project, but may be required should a future project become profit-making. An internal review of the financial model inputs and outputs has been carried out that confirmed the annual cash-flows within a 12% tolerance. Given the uncertain nature of forecasting generation and demand profiles and the variance these can cause in the financial model, the 12% tolerance achieved in the review is regarded as adequate in verifying that the financial model is fit for purpose.

7.7 The grant of the licence to supply electricity

7.7.1 Ofgem confirmed by letter on 18 October 2016 that it is minded to grant the GLA's Licence Lite application and that there are no outstanding issues, providing no substantial changes are made to the form of Supplier Services Agreement to be signed with RWE npower. No substantial changes are anticipated. It is expected therefore that the licence will be granted upon the GLA sending Ofgem a signed version of the Supplier Services Agreement. That would follow this requested Mayoral Decision.

7.7.2 The licence contains obligations. These are, in conjunction with the supplier services provided by RWE npower, capable of fulfilment by the GLA. Principal obligations and risks attached to them are referred to in paragraph 6 above and contained in the Risk Matrix (Annex 3).

7.8 Timetable

Activity	**Timeline**
CIB recommend MD	14th August 2017
MD signed by Major	21st August 2017
RWE nPower agreement signed	22nd August 2017
Ofgem grant licence	27th August 2017
Generator PPAs signed	24th August 2017
TfL SA signed	24th August 2017
TfL notify existing supplier to remove Northumberland Park and Northfields Depot from current supply arrangements.	1st September 2017
First electricity traded	1st October 2017

Appendices and supporting papers

Annex 1
Business Plan Due Diligence Executive Summary

Annex 2 Transport for London Direction

Public access to information Information in this form (Part 1) is subject to the Freedom of Information Act 2000 (FOI Act) and will be made available on the GLA website within one working day of approval. If immediate publication risks compromising the implementation of the decision (for example, to complete a procurement process), it can be deferred until a specific date. Deferral periods should be kept to the shortest length strictly necessary. **Note**: This form (Part 1) will either be published within one working day after approval or on the defer date.
Part 1 Deferral: **Is the publication of Part 1 of this approval to be deferred? NO**
Part 2 Confidentiality: Only the facts or advice considered to be exempt from disclosure under the FOI Act should be in the separate Part 2 form, together with the legal rationale for non-publication. **Is there a part 2 form – YES**

ORIGINATING OFFICER DECLARATION:	Drafting officer to confirm the following (✓)
Drafting officer: **Peter North** has drafted this report in accordance with GLA procedures and obtained external legal advice and comments and confirms the following have been consulted on the final decision.	✓
Sponsoring Director: Fiona Fletcher – Smith has reviewed the request and is satisfied it is correct and consistent with the Mayor's plans and priorities.	✓
Mayoral Adviser: Shirley Rodrigues has reviewed the request and is satisfied it is correct and consistent with the Mayor's plans and priorities.	✓
Advice: The Finance and Legal teams have commented on this proposal, in addition to external advice.	✓
Corporate Investment Board This decision was agreed by the Corporate Investment Board on the 14th August 2017.	

EXECUTIVE DIRECTOR, RESOURCES:

I confirm that financial and legal implications have been appropriately considered in the preparation of this report.

Signature M. D. Elle **Date** 14.8.17

CHIEF OF STAFF:

I am satisfied that this is an appropriate request to be submitted to the Mayor

Signature D. Bellamy **Date** 21/8/2017