

GREATER LONDON AUTHORITY

REQUEST FOR MAYORAL DECISION – MD1663

Title: Developing a new junior electricity supply licence ('licence lite')

Executive Summary: The GLA has applied to the regulator Ofgem for a 'junior' electricity supply licence (known as a "Licence lite") whereby, with the support of a fully licensed supplier, it can purchase the output of low and zero carbon electricity generators and supply it to public and commercial electricity users in London under terms that support the development of decentralised energy in London.

This MD is a request for a decision to approve the draft outline financial model and business plan so that immediate actions needed to proceed with the project can take place. These actions include in particular the publication of the GLA's electricity supply licence application by Ofgem and the processes involved with that, and subsequently negotiations with decentralised energy generators and consumers in order that the project can proceed to operational readiness.

The decision is required at this stage in the Mayoral term because of the practical requirement of maintaining deadlines to move the project forward and retain stakeholder interest and involvement with it. The immediate and important deadline is with RWE npower (the licence lite market services provider) to deliver to the energy regulator Ofgem the final operational arrangements required to be seen by Ofgem, prior to Ofgem publishing the GLA's licence application; and also negotiations with decentralised energy generators and licence lite electricity customers, with a view to the project being ready for operation by the end of June 2016 target date, subject to the new Mayor's decision.

No contracts or binding commitments will have been entered into and the new Mayor can decide whether or not to press ahead and how to structure governance and steering of the project, but maintaining progress in the meantime ensures that the new Mayor retains those choices.

Decision:

The Mayor:

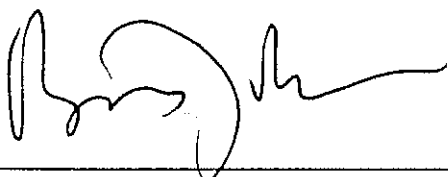
1. Approves the draft business plan and financial model for the licence lite project
2. Approves expenditure of up to £100,000 (£50,000 for a due diligence report and £50,000 working capital expenditure on external market advisory and external legal support) to be funded through licence lite income at nil net cost to the GLA
3. Notes the proposal to establish a supervisory forum, to comprise a Mayoral advisor and GLA officers, which will provide detailed assessment and steering in respect of bringing the licence lite project into operation, should its continuance be approved. Decisions will continue to be taken in accordance with the Mayoral Scheme of Delegation.

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:

30.4.2016

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

Decision required – supporting report

1. Introduction and background

- 1.1 The Mayor of London has set a target to meet 25 per cent of London's energy supply from decentralised energy by 2025. The Decentralised Energy Capacity Study (GLA 2011) confirmed this target as being achievable based on both renewable and low carbon energy sources and that it represented an £8 billion investment opportunity.
- 1.2 The licence lite project is designed to support the development of decentralised energy in London and when operational the licence lite project would fall within the Energy for London project, to be established pursuant to MD1542. The GLA's application to Ofgem for a licence lite licence was approved by DD897, as varied by DD1416, on the basis that Mayoral approval is obtained before any commitment to supply electricity is made.
- 1.3 The licence lite model involves the GLA obtaining a junior electricity supply licence whereby, with the support of a fully licensed electricity supplier, it can purchase the output from low and zero carbon electricity generators and supply the electricity produced to public and commercial electricity users in London, whose volumes and timing of electricity consumption offer the optimal income to the generators, relative to their costs. The GLA in effect acts as a facilitator, securing the best market for the electricity at the best available price, in return for taking a margin on the income received to cover its costs and retain a surplus.
- 1.4 Under the licence lite model and regulatory system, the GLA as licensee is relieved of its obligation as a licensed electricity supplier to be a party to the principal industry market codes and avoids the 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 GLA procures electricity from low and zero electricity generators and supplies it to selected public sector and commercial consumers in London. The model is low cost and risk compared with current mainstream electricity supply activities and offers to small scale low and zero carbon electricity generators a better route to market with the prospect of enhancing their revenues.
- 1.5 The licence lite project has now reached an advanced stage –
 - an electricity supplier (RWE npower) which is a party to the market codes has been appointed by public tender to provide the necessary market interface services;
 - a panel of low and zero carbon electricity generators with generating capacity in London has been appointed by public tender to a procurement framework, namely London Boroughs of Camden, Haringey, Havering, Islington and City of Westminster, the Peabody Trust, Scottish and Southern and Vital Energi;
 - the regulatory arrangements connected with the grant of the electricity supply licence have been settled and subject to receiving shortly some further operational protocols from RWE npower, Ofgem is able to publish the licence application, with a view to granting it 45 days thereafter ;
 - a detailed financial model has been prepared, demonstrating the financial viability of the project, on the basis of offering potential customers for the GLA's electricity a discount on their current prices and the generators the prospect of a material enhancement to their income;
 - the generators have been individually consulted to ensure that the criteria and methodology the GLA will use to negotiate prices with them for the purchase of their energy are realistic and conform to their expectations;
 - the terms of the agreement with npower for the provision of the market interface services are settled in material respects and forms of agreement for detailed negotiation with the generators and prospective electricity customers have been prepared. These forms of agreement with

generators and prospective electricity purchasers follow established industry terms, save for the pricing and some other provisions specific to the licence lite model.

- 1.6. The next step is to bring the licence lite project to an operational stage, principally involving the following activities, to be accomplished broadly in parallel –
- securing the grant of the licence from Ofgem, on the basis settled with them, beginning with the formal publication of the GLA's licence application, with a view to its grant 45 days thereafter;
 - finalising the detailed aspects of the forms of agreement as above;
 - matching the procured electricity generating capacity with the prospective customers for the electricity, to secure the financial relationships provided for in the financial model;
 - settling with TfL the availability and timing of TfL premises to be supplied with low and zero carbon electricity through the GLA's licence lite operation;
 - completing a full business plan and also operational plans incorporated in a handbook;
 - completing a due diligence exercise by independent external advisors to verify that the assumptions in the financial model, the forms of legal agreement and operational plans comply with the objectives;
 - Creating a post for and appointing a Chief Operating Officer, initially on a part time basis.
- 1.7. These next steps involve making operational decisions about the details of the commercial and financial relationships with its counterparties in the project, how the licence lite operation will run, manage its resources and risks and secure its intended financial margins. They are best supervised by a board of GLA staff and Mayoral adviser and others, able to scrutinise and provide an independent perspective on the decisions and processes of the officers managing the progress of the licence lite project.

2. Objectives and expected outcomes

- 2.1. The project will benefit both public and private sector groups that have an interest in delivering low and zero carbon decentralised energy schemes in London, through enhancing their prospective revenue streams from electricity generation. As described below, the current detailed financial model demonstrates this and the revenue enhancement and the licence lite margins have the potential to grow as the licence lite operation grows and is able to spread its overheads more widely. Specifically:
- the licence lite financial model demonstrates that on current and forecast electricity prices the GLA as electricity supplier could offer to DE electricity generators an increase in electricity revenues of between 10 and 20 per cent;
 - taking into account the strong negotiating leverage of TfL as a bulk purchaser of electricity, the licence lite model can offer TfL a minimum discount of 5 per cent on its current and forecast prices and other financial incentives. Other public sector and commercial consumers in London with less electricity demand and less negotiating leverage in the electricity market might be able to negotiate higher discounts with the licence lite operation;
 - the GLA's licence lite model also offers London boroughs to be supplied with low and zero carbon electricity which they generate themselves or purchase from other sources of low and zero carbon electricity, at prices that are 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;
 - the licence lite model can 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 may include electricity generated from solar energy schemes, thus improving their prospects of financial viability following the reduction of government support

- 2.2 The current detailed financial model shows a margin for the early years of between approximately 5 per cent. This is after meeting the internal as well as the external costs of the GLA in operating licence lite, notably staff time in managing its operation and other services provided by existing GLA resource, the invoicing of GLA electricity consumers and arranging the invoicing from the generators. The total staffing of the licence lite operation during its first year of operation is calculated to be 0.8 FTE per annum. It is anticipated that the financial margin will increase –
- as the volume of electricity supplied increases from a low level, consistent with the licence lite operation beginning as a pilot scheme. The financial model has been based on a conservative estimate of turnover during the first year, using a turnover figure of £2.2m and a consumption capacity supplied of 4.6 MW. For the purposes of providing conservative verification of viability for subsequent years, a similar turnover of approximately £2m has been used. However, the objective is that by the end of the first operating year, the total level of consumption supplied will be approximately 10 MW, with a pro rata increase in turnover;
 - as premises are supplied that, as explained above, do not have the negotiating advantages of TfL's premises and pay higher prices for their electricity;
 - if and when wholesale electricity prices rise generally, although no assumption in the financial model is made regarding that.
- 2.3. The financial margins produced by the licence lite operation can help finance the delivery of the Energy for London objectives, through contributing to the costs of the staff and external services involved. The licence lite operation is part of Energy for London's functions, supporting DE development in London.

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. Decentralised energy, of which this licence lite project forms part as a project dedicated to securing its growth, along with energy efficiency, form 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 The licence lite project would fall within the Energy for London project approved under MD 1542, the purpose of the project being to support investment in decentralised energy.
- 4.2 Other considerations relate to key risks and issues and links to the Mayor's strategies and priorities, described in paragraph 5 below.

5. Key risks and issues

There are key risks and issues associates with proceeding with the project.

Risk/Issue	Mitigation	Rating
The new Mayor being fettered by a commitment to the Energy for London project that goes beyond May 2016	The decision here does not commit the new Mayor who can still decide whether to press ahead, and how to structure governance and steering of the project	Low risk All political parties share a commitment to reduce carbon emissions, so there is little risk, at a strategic level, that this would not be a priority for the new Mayor
The new Mayor may want to change or stop the licence lite project	In the event that a new Mayor wanted to stop supporting the DE programme through licence lite, there is a break clause in the contract with RWE npower (the GLA's market services provider) if the GLA decides no longer to continue with licence lite operations. The contract with all electricity generators and customers will be of fixed length and able to expire and not be renewed.	Low risk
Regarding the licence lite project itself, there is a mis-match between the actual prices offered by electricity generators on tender and those acceptable to potential licence lite customers that results in the project being uneconomic	Both prices payable by and payable to the GLA under its licence lite project have been tested by advice from market specialists, on the electricity customer side, tested against actual and future prices payable by TfL in the market and by testing the GLA's prospective pricing strategies with the generators. If market conditions caused the project to become uneconomic for the future, the GLA would not renew its contracts to purchase electricity from the generators and its supply to consumers.	Medium risk
The small scale low and zero carbon electricity generators from whom the GLA buys its electricity for supply to its customers break their commitments to generate and cause the GLA unexpected expense in replacing the lost electricity by market purchase, undermining the viability of the business model	The risk is spread between generators who will take all or part of the risk themselves. The GLA also has a strategy to purchase more electricity than it needs and has arrangements with RWE npower to sell the excess to them. These arrangements will be specified in an operational handbook, with the mitigation measures.	Low to medium risk
There is regulatory change that	Ofgem has been consulted at each	Low

makes the licence lite operation uneconomic or frustrates its future operation.	stage of the formation of this project. All the relevant contracts contain change of law and force majeure clauses which enable the project to be modified where practical or otherwise terminated	
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6. Financial comments

- 6.1. All activities in relation to the Licence Lite project will be conducted at net nil cost to the GLA.
- 6.2. It should be noted that the figures provided in the summary of the Financial Model are estimates and significant due diligence is required prior to the project being ready to commence operation by the end of June 2016 target, including review of the Financial Model by GLA officers.
- 6.3. The opportunity to supply TfL (the principal customer) is likely to be delayed, the risk of which to the viability of the financial model needs to be further explored and quantified during assessment of the Business Plan and Financial Model.
- 6.4. Expenditure of up to £100,000 will be incurred in 2016/17 to procure financial advisors to undertake due diligence work (up to £50,000) and to fund external market advisory and legal support (up to £50,000). In the event that expenditure is required in advance of resources being available, the GLA will fund the costs on the basis that it will be reimbursed at the point where the project generates a surplus, which based on the financial model will be at the end of 2016/17.
- 6.5. Additional expenditure related to the cost of a part time Chief Operating Officer for licence lite operations (up to £49,000) is proposed to be part of the operating expenses in the business model and therefore also to be funded through licence lite income at nil net cost to the GLA.
- 6.6. It should be noted that the total expenditure the GLA had incurred to date on Licence Lite is approximately £201,000 (procurement, consultant advisory and staff time) and the GLA will offset all of this expenditure incurred against the revenues generated by the project.

7. Legal Comments

- 7.1 The GLA has powers under the Greater London Authority Act 1999 (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 that Act) to address climate change, so far as relating to Greater London. Under section 34 of the Greater London Authority Act 1999, the GLA may do anything calculated to facilitate, or conducive or incidental to, its functions.
- 7.2 Provided that implementation of these 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.
- 7.3 It is understood that at present what is proposed is purely a pilot scheme. In piloting this scheme, the GLA does not appear to be exercising its powers for a commercial purpose.

7.4 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.

- 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.
- Under s95(4) of the 2003 Act the GLA must exercise its powers to do so through a company.
- Further, 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.”

7.5 Any proposals should be reviewed generally on preparation of a business case.

8. Investment & Performance Board

The request for a Mayoral Decision was approved by the Investment Performance Board at its meeting on 19 April 2016.

9. Planned delivery approach and next steps

Activity	Timeline
Finalisation of forms of contract with generators and RWE npower for signature	30 April 2016
Completion of schedule of quantity and timing of available generating capacity and quantity and timing of electricity demand from the GLA’s licence lite customers	15 April 2016
Completion of risk register	30 April
Completion of operations manual	15 May 2016
Grant of licence by Ofgem	1 June 2016
Commencement of operations	30 June 2016

Appendices and supporting papers: none

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

If YES, for what reason:

Until what date: (a date is required if deferring)

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 – NO

ORIGINATING OFFICER DECLARATION:

Drafting officer to confirm the following (✓)

Drafting officer:

Robert Tudway has drafted this report in accordance with GLA procedures and confirms the following have been consulted on the final decision.

✓

Assistant Director/Head of Service:

Patrick Feehily has reviewed the documentation and is satisfied for it to be referred to the Sponsoring Director for approval.

✓

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:

Matthew Pencharz has been consulted about the proposal and agrees the recommendations.

✓

Advice:

The Finance and Legal teams have commented on this proposal

✓

EXECUTIVE DIRECTOR, RESOURCES:

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

Signature *M. D. Alce*

Date *29.4.16*

CHIEF OF STAFF:

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

Signature *Edward ...*

Date *29.04.2016*