



FACT SHEET: AN INTRODUCTION TO GENERATING AND SELLING ELECTRICITY AT RESIDENTIAL DEVELOPMENTS WITHOUT AN OFGEM LICENCE



SUMMARY

Supplying electricity to tenants: an introduction to exemptions to the requirement for a licence

Developers, landlords and ESCos are increasingly attracted to providing residents with electricity as part of their overall service offering. This is often linked to the provision of heat, where a combined heat and power (CHP) plant is used. The commercial drivers for this can be a landlord in the private rented sector wishing to offer a one stop shop living experience to short and medium term tenants, or public/private sector developers that see an advantage in their customers benefiting from the lowest possible energy costs.

Measures that reduce energy costs to residents are becoming increasingly important as the country pivots away from gas to more expensive zero carbon technologies. This puts more focus on bringing together heat and power into integrated local energy systems. Integrated local energy systems can facilitate the stacking of benefits and costs savings that can bring down the cost of zero carbon heating to residents. Making best use of on-site generation and the bulk purchase of electricity can deliver considerable savings, which can offset some of the additional cost of low carbon heating.

The supply of electricity to a premises generally requires a licence from Ofgem. However, this note introduces the exemptions that can apply and that can offer landlords the opportunity to sell electricity to residents connected to a site's privately operated electricity network.

This document will provide an introduction to the four main topics of:

- the resale of electricity to residents;
- the distribution of electricity generated on-site to residents and small-scale supply;
- the question of, "Do residents have the right to choose an alternative electricity supplier?"; and
- electric vehicle charge points.

You will also find case studies of typical scenarios.

RESALE OF ELECTRICITY TO RESIDENTS

Resale commonly occurs when a landlord provides power to the residents of a building having first been supplied with that power, at that building, by a licensed supplier. Similarly, resale is likely to be occurring at a larger site containing a number of different buildings if the power is being provided to residents and tenants via an arrangement in which a landlord or ESCo bulk purchases the electricity for all the separate units at that site.



The reseller will normally be purchasing electricity from a licensed supplier and a reseller cannot provide the electricity to a separate premises from that at which the reseller was supplied. (The reseller could alternatively purchase the power from a licence exempt on-site supplier (see below) and there are some very limited exceptions related to on-selling of on-site supply). Owners or operators of multiple premises will therefore have to enter a separate supply contract with a licensed or on-site supplier in respect to each site at which they then resell power.

Whatever the precise contractual arrangements at a premises, the resale of electricity is subject to a maximum resale price (MRP) cap set by Ofgem if the electricity is resold for (ultimately) domestic use or for use in any accommodation.

The provisions of this price cap mean that:

- the reseller cannot charge residents more per unit of electricity (kWh) than it pays to the licensed supplier;
- any standing charges paid by the reseller must be pro-rated with the amounts payable for the unit rates (and if the reseller is also a resident, they need to be included in this pro-rating);
- metering of resident consumption is preferred, but where not possible then the reseller must use reasonable endeavors to estimate consumption instead (and there are detailed provisions on what this requires);
- if the reseller exceeds the maximum price cap then the excess plus interest (set at twice the average Barclays Bank base rate) is recoverable by the resident(s); and
- resellers must, on request from residents or potential residents, provide the prices payable and documentary evidence supporting those prices. Failure to do this in a timely fashion can lead to the cap being reduced by twice the Barclays Bank base rate and for the period from when the request for information was made until it is met.

However, the MRP cap does not prevent the provision of electricity by the reseller being part of the wider commercial package offered to domestic residents and in relation to which there may, for example, be service charges (again, so long as the element of that proposition that is the resale of electricity is within the MRP provisions relating to unit rates, standing charges and transparency).

Equally, the MRP cap does not prevent a profit from being made from the resale of electricity for non-domestic use other than in accommodation (office, retail or other commercial tenants do not benefit from the MRP).

Note also that the MRP is not the same as the current retail energy price cap, which limits the rate of charges payable by many domestic customers of licensed suppliers. The retail price cap will not apply between the reseller and supplier, as the reseller will not be a domestic customer (and in practice a landlord or ESCo reseller is anyway likely to strike a better deal with a licensed supplier); equally, the retail price cap will not apply as between reseller and domestic residents.

EXEMPTIONS WHERE GENERATING, DISTRIBUTING AND SUPPLYING ON-SITE OR AT A SMALL SCALE

Other exemptions from the requirement for a supply licence are available for small-scale operations and there are associated exemptions too from requirements for electricity generation and distribution licences. For some developers, landlords or ESCOs these exemptions may provide opportunities for commercial exploitation.

On-site supply allows self-generated power to be supplied at the same site as generation occurs. No more than 1MW of power can be supplied to domestic consumers, however additional power may still be provided to the premises by a licensed supplier.

An exemption also exists for small suppliers (which may be supplying to more than one site) if supplying only self-generated electricity and provided that no more than 5MW of power is supplied at any time, of which no more than 2.5MW is supplied to domestic customers.



Related to this, the distribution of low voltage power is also exempt from the need for a licence if distributing no more than 2.5MW to domestic consumers (or if distributing exclusively to non-domestic customers). A generation licence is not required for small-scale generation of electricity (with a general threshold of 10MW meaning CHP is very unlikely to be caught).

The number of apartments or houses that can be served by a 2.5MW supply (ie small supply) will depend on the diversification factor used in the distribution network design. This factor is approximately 2kW per apartment when the electricity is not used for heating and this would suggest the maximum number of apartments served under a small supplier and distribution exemption would be 1250. For the 1MW on-site supply exemption, this may mean around 400-500 apartments.

Ofgem has the power to set price caps and there are important limitations and details related to the licence exemptions such as power thresholds: the details of schemes and the various exemptions will always need careful consideration. However, the potential exists for landlords and ESCos to develop revenue streams.

CAN TENANTS SWITCH SUPPLIER AND WHAT ABOUT THIRD PARTY ACCESS TO THE NETWORK?

One potential concern can be that tenants may want to switch to alternative suppliers and that the landlord or ESCo may be left in a position in which it has to grant access to the on-site network.

If there is an arrangement in place under which it is the landlord that is responsible for paying for the supply to the premises, then tenants are unlikely to have a right to switch supplier as long as that arrangement between the landlord and tenant remains in place (although there is nothing to stop the tenant asking to switch). Rentals of individual units directly connected to the public grid but where the landlord pays the licensed supplier (and recovers the costs from the tenant in rent and service charges) are perhaps the most obvious example of this.

Resale arrangements and other forms of licence-exempt supply may well link the provision of power to leases (in particular shorter ones) and may, for example, offer financial benefits to not switching if the final price paid by the tenant is no higher than what would be paid to a licensed supplier.

Ultimately however, tenants do have a right to switch supplier where they are engaging with and paying the (licensed or licence exempt) supplier. Licence exempt suppliers such as (potentially) a landlord or ESCo need to provide terms and conditions that dictate when the supply contract will terminate; supply contracts tied to rental tenancies (for example) run the risk of creating very long supply contracts that domestic tenants are required to enter into when moving into a property and may be deemed unfair under consumer protection legislation.

Licence-exempt suppliers are also required to notify tenants of any intended increases in charges and tariff rates and to inform the tenants of their termination rights whenever doing so.

If a tenant is motivated to find an alternative supplier then, if the landlord or ESCo is also operating the relevant private network, it will need to engage with the process of providing third party supplier access to that network. Such access can be resisted if it will require additional capacity on the network that would either not be technically feasible or have a significant adverse economic impact on the landlord/ESCo. Third party access may be provided with a new metering arrangement (connecting to the public network or metering within the private network) or through contractual arrangements; and whilst charges may be levied for any works that are required ('reasonable expenses'), the third party cannot be treated less favourably than existing users of the network. Ofgem will need to approve any use of system charging methodology.



WHAT MIGHT THIS MEAN IN PRACTICE?

Two example scenarios are illustrated below.

Scenario one

A site of 300 residential apartments with a small amount of commercial use (offices and retail). An ESCo is responsible for supplying heat and electricity on the site.

The site benefits from a heat network and on-site generation in the form of a heat led CHP engine that is designed to cover 70% of the annual heat load.

The CHP engine generates about 20% of the electricity demand with the remainder being imported from the grid. No electricity is exported to the grid as the CHP generation is less than the site base load.

Residents are billed for electricity and heat consumption by the ESCo.

Scenario two

Site of 300 residential apartments with a small amount of commercial accommodation. This site benefits from a zero carbon heat network powered by a water source heat pump. There is a small amount of on-site PV generation. The ESCo is responsible for providing heat and electricity to the apartments. Electricity is imported from the grid and resold to the residents by the ESCo.

Whilst the factual description of scenario two differs from scenario one, the regulatory analysis is largely the same. On-site generation and supply is not, in this scenario, going to require a licence as long as the 1MW limit is not breached (which is unlikely with 300 apartments). However, the majority of power will again be purchased from a licensed supplier, imported from the grid and resold (again without the need for a licence) by the ESCo. The resale will be subject to the MRP cap and therefore will not be a profit making activity for the ESCo save for where the power is then used for non-domestic and non-accommodation purposes; here the 'commercial accommodation' will therefore need careful consideration.

In practice, Switch2 has found that the lower cost of buying electricity from the licensed supplier at the bulk meter can still allow electricity to be resold to the residents at a lower price than they can achieve directly from a licensed supplier even when the costs of metering and the maintenance of the distribution network are recovered by the ESCo.

ELECTRIC VEHICLES

As electric vehicles (EVs) become more commonplace, so will the requirement for EV charging points in car parks serving residential developments.

Since charging an EV involves providing electricity to a car and not a premises, it does not constitute 'supply' and it does not require a licence. It is also not subject to energy retail price controls.

Providing electricity to the charge point is supply, although in practice it will often be licence exempt resale because the power will first have been provided to the building or site by a licensed supplier before being relayed to the specific charge point. In practical terms this is likely to mean that an ESCo with EV charging points in a site car park or attached to domestic residences is engaged in resale, not requiring a licence.

Whether the final use of the power is classed as 'domestic' will affect whether the MRP resale price cap applies. Ofgem's view appears to be that for public car parks, EV charging is 'likely' to be non-domestic. However, where the charge point is in a home or car park provided as part of accommodation it seems much more likely that the MRP will apply, however precise details will be important.



DETAILS ARE IMPORTANT

This note provides an introduction to the exemptions for the requirements for a supply (and distribution and generation) licence, which provides the opportunities for developers, landlords and ESCos to provide power to their residents, in particular when that power is provided as an additional benefit of CHP usage.

However, it is important to note that the exemptions are limited and still entail some regulatory requirements, including providing terms and conditions to customers and providing third party access to distribution networks. The detailed rules surrounding exemptions require very careful analysis and application to any proposed scheme prior to development.

This note does not consider business models such as 'white labelling' (where a supplier uses another business's branding to sell energy) or 'licence lite' (where another supplier takes on many, but not all, of the regulatory obligations). They will be generally less relevant for landlords, but may provide a route to market for a property business wanting to diversify into energy supply. It is also important to note that providing electricity and the services that are likely to surround that provision will also be subject to general consumer protection laws relating, for example, to unfair contract terms, which have not been considered here. This note is an introduction to the issues only and does not constitute legal advice.

GLOSSARY

Licensed supplier: a business selling electricity to the premises of domestic or non-domestic customers. Supplying electricity usually requires a licence from Ofgem, unless an exemption applies (and this note discusses relevant exemptions for landlords and ESCos). Licensed suppliers are the well-known energy retailers that are subject to often quite detailed Ofgem regulation. Licensed suppliers buy electricity from generators and the power is transported via the national high-voltage transmission system and public and sometimes also private distribution.

Premises: private site or building.

Third party access: allowing a customer to switch supplier.

Diversification factor: the ratio of the sum of all the maximum individual apartment demand for electricity to the maximum demand the whole site is likely to experience. In this case the maximum potential demand for an individual apartment may be 80kW however.

Ofgem: the regulator of the British gas and electricity markets (and probably of heat networks in the future). Ofgem issues licences to suppliers, generators and network operators that require them and that meet Government and Ofgem requirements. Ofgem also imposes licence conditions (for example breaches) and can investigate and penalise.

FIND OUT MORE

For further information, please contact:



JOHN DOHERTY
Partner, Energy regulatory law
T: +44 (0)20 7872 8575
E: john.doherty@penningtonslaw.com
www.penningtonslaw.com



IAN ALLAN
Head of Market Strategy, Switch2 Energy
T: 01274 535531
M: 07831 782646
E: ian.allan@switch2.co.uk
www.switch2.co.uk