

Report to Executive

Agenda
Item:

A.2

Meeting Date: 2nd February 2015
Portfolio: ECONOMIC DEVELOPMENT
Key Decision: Yes
Within Policy and Budget Framework
Public / Private Public

Title: **ENERGY SUPPLY PARTNER**
Report of: DIRECTOR OF ECONOMIC DEVELOPMENT
Report Number: ED.07/15

Purpose / Summary:

A soft market testing exercise to seek expressions of interest from Companies wishing to become an Energy Supply Partner to the Council was carried out at the end of last year. It has been also agreed that a partnership model offered the best balance between risk and reward – offering opportunities to engage with our communities to reduce fuel poverty, while offering a potential income stream. The exercise resulted in four companies expressing an interest in partnering with the City Council to become an Energy Supply Provider. A timeline was also agreed and the next stage in the process is to seek Executive approval to undertake a formal tendering process to secure a Partner. The benefits to residents will be to reduce fuel bills, so increasing disposable income, reducing fuel poverty and offering access to cheaper tariffs for those on pre-payment meters.

Recommendations:

The Executive is asked to approve:

1. That the tendering process to secure an Energy Supply Partner is taken forward.
2. That, following procurement, the Council and the successful Provider will establish a business model for the marketing and supply of energy and seek further approval by the Executive.

Tracking

Executive:	2nd February 2015
Overview and Scrutiny:	
Council:	

1. BACKGROUND

The Energy Market and Fuel Poverty

1.1 Across the UK and the Republic of Ireland there has been a growing disquiet with perceived failings in the energy market and the escalating costs of energy; even though there may be some reductions due to dropping oil prices at the moment. Within the local government sector, Councils are increasingly concerned that the market is not just “broken” but is failing local communities, particularly the poorest groups suffering from increased levels of fuel poverty. For example, consumers feel that not all of the current reductions in wholesale markets will be passed on to them.

Within a policy context of potential future reforms to the energy market, there are a number obvious reasons for considering increased activity in the development of energy policy in Carlisle. These include:

- The City Council is a large consumer of energy and energy prices can markedly affect the Council’s cost base for delivering services.
- The impact of fuel poverty in the District has a significant impact on the Health and Wellbeing of the locality.

The 2012 Private Sector Stock Condition survey highlighted that around 22.2% private sector households (owner occupiers and private tenants) were in fuel poverty. As energy prices have increased significantly since 2012, it is assumed that the estimated 9,000 households in fuel poverty will have increased.

Policy context

1.2 It is now possible for community groups and local authorities to become partners with an Energy company in the energy supply market; removing some of the barriers to entry that had existed previously.

The necessary requirements to become an energy supplier are complex and involve, for example, a number of IT related steps bound by regulation. This complexity has prevented new entrants from entering the market especially if they are from the community or local authority environment. Any new entrant will need also to have access to the wholesale energy market or be able to generate their own energy for sale into the market. They would also have to set up their own customer service and billing operations.

For any potential Energy Supply Partner, there are clear benefits in using the trusted and reliable brand of the Council as a way of marketing their offer to residents. The key objective for them is to switch new customers to their company's offer.

Benefits to the Council and Residents

1.3 For the Council, the benefits of becoming an energy supplier would be that it could generate income for the local authority through selling energy which is either sourced from the Partner or that the Council has generated itself and offer help to disadvantaged groups to reduce their bills such as those on pre-payment meters.

For residents, the arrangement also would potentially provide access to cheaper tariffs and other benefits such as smart meters replacing prepayment meters for vulnerable groups who cannot access cheaper tariffs - typically 25% more expensive than tariffs found through direct debit and online. This will help people with their bills and free up household income to grow the local economy.

National Tariffs

1.4 Currently Energy Suppliers are only able to offer 4 national tariffs, a potential partner would probably offer one of these tariffs for use by the Authority to market and sell to its residents. The Partner would offer the Council Electricity and Gas at a wholesale rate and offer a route through this tariff for the Council to sell its own generated power into the market in the future.

Outcome of Soft Market Testing Exercise

1.5 It was agreed following a report to JMT in October that we should first seek expressions of interest through a soft market testing exercise and this concluded at the end of November. We were successful in attracting 4 potential partners. These are:

- British Gas
- OVO Energy
- Smart Metering Systems
- Utilyx

British Gas and OVO Energy are Energy Supply companies supplying the retail market. Utilyx and Smart Metering Systems are IT/Data companies.

2. NEXT STEPS

2.1 The next stage in this process, subject to approval by the Executive, is to proceed to tender via a specification. This will set out the requirements that the Council will expect of a Partner and ask potential partners to set out their proposals and make clear their financial offer to the Council. After a Partner has been procured, under OJEU, the business model will be established and taken forward. The offer will then be launched and marketed to Carlisle residents.

Business Model

2.2 The initial proposed Business Model will be to establish a social enterprise under the Homelife branding to market the tariff to residents. This will be part of the specification in the tendering process and will need to be negotiated and agreed once a Partner has been procured.

3. CONSULTATION

3.1 The decision to tender for an Energy Supply Partner will be made by the Executive. The proposal forms part of a wider initiative on energy use and generation.

4. CONCLUSION AND REASONS FOR RECOMMENDATIONS

4.1 Becoming an energy supplier would allow the Council to maximise the income from future generation of energy and gain a potential income stream to invest in services.

4.2 The offer to residents would also be substantial in that we can give residents the opportunity of obtaining cheaper electricity and gas, which would reduce fuel poverty and have a significant effect on their ability to spend money both in the local economy and to manage their household budgets. We could also offer changing card meters to smart meters to some of our most vulnerable residents. This would give them the opportunity of gaining from the cheaper tariffs normally only available to direct debit customers.

4.3 This offer could also be coupled with other energy efficiency measures and services to help both improve homes and save residents money on their energy bills. A key aim of the initiative is to reduce fuel poverty and maximise disposable income.

5. RECOMMENDATIONS

5.1 The Executive is asked to approve:

- 1.** That the tendering process to secure an Energy Supply Partner is taken forward.

2. That, following procurement, the Council and the successful Provider will establish a business model for the marketing and supply of energy and seek further approval by the Executive.

6. CONTRIBUTION TO THE CARLISLE PLAN PRIORITIES

6.1 Meeting Carlisle's current and future housing needs is a priority in the Carlisle Plan. This report presents specific proposals to address the Council's priority to tackle fuel poverty.

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**Appendices Appendix 1 : JMT Briefing Paper
attached to report:**

Note: in compliance with section 100d of the Local Government (Access to Information) Act 1985 the report has been prepared in part from the following papers:

- **None**

CORPORATE IMPLICATIONS/RISKS:

Chief Executive's -

Deputy Chief Executive –

Economic Development –

Governance – The Local Government Act 2000 (Section 2) provides that the Council has the power to do anything which it considers likely to achieve the promotion or improvement of the economic, social or environmental well-being of its area. The power may be used in relation or for the benefit of the whole or any part of the community or all or any persons present or resident in the Council's area.

The Council is able to incur expenditure; give financial assistance to any person; enter into agreements or arrangements with any person; co-operate with, or facilitate or co-ordinate the activities of any person; exercise on behalf of any person any functions of that person; and, provide staff, goods, services or accommodation to any person. In exercising the power, the Council must have regard to its Community Strategy. These are the types of matters which the Council will be involved with should it proceed to partner with an energy supply company.

Reference is made in the report to procurement and it is apparent that the sums involved required an OJEU procurement process. Any agreement with a successful bidder must be properly documented in an appropriate contract.

Financial -

The financial implications of this proposal cannot be quantified as yet but if Members approve the procurement process, which must be carried out in line with Contract Procedure Rules and an OJEU process, then a full financial appraisal and business model detailing the financial consequences will be reported to a future meeting of the Executive. Any new partnership arrangements which are established as a result of the process must comply with the Council's Partnership guidance notes with all associated risks being identified and assessed.

HR -

Local Environment –

JMT Briefing Paper – 13th October 2014

Energy Supply Partner

Introduction

This report outlines the background, policy context and mechanics for the development of the Council becoming an Energy Supplier.

Background

Across the UK and the Republic of Ireland there has been a growing disquiet with perceived failings in the energy market and the escalating costs of energy. Within the local government sector, Councils are increasingly concerned that the market is not just “broken” but is failing local communities, particularly the poorest groups suffering from increased levels of fuel poverty.

Within a policy context of potential future reforms to the energy market, there are a number obvious reasons for considering increased activity in the development of energy policy in Carlisle. These include:

The City Council is a large consumer of energy and energy prices can markedly affect the Council's cost base for delivering services. The impact of fuel poverty in the District also has a significant impact on the Health and Wellbeing of the locality.

The 2012 Private Sector Stock Condition survey highlighted that around 22.2% private sector households (owner occupiers and private tenants) were in fuel poverty. As energy prices have increased significantly since 2012, it is assumed that the estimated 9,000 households in fuel poverty will have increased.

Policy context

An influential report by the policy think-tank, the Institute for Public Policy Research (IPPR), outlines five potential business models for Local Authorities to meet their objectives for engaging with the energy sector and developing energy supply :

1. Becoming a fully licensed supplier (a full, definitive Energy Supply Company) e.g. Nottingham City Council.
2. Going into a joint venture with an independent supplier.
3. Operating a 'licence lite' approach where the Council becomes a junior supplier. The Greater London Authority is pursuing this approach
4. Establishing a partnership with an existing supplier in which energy is provided using the supplier's existing licence and the delivery of operational aspects of the business is shared. Ovo Energy has indicated that numerous local authorities

have inquired about establishing a partnership arrangement through their 'Ovo Communities' offering. Plymouth City Council have signed up to this deal.

5. Creating a white label - the Council licenses use of its brand to an existing supplier who uses it to market to local companies. An example of a white label approach is Sainsbury's – the supplier is Centrica/British Gas.

The appendix to the IPPR report includes a detailed analysis of the pros and cons of the different options, to assist local authorities in determining the appropriate model they might pursue.

Table 1.1 summarises this analysis using a traffic light system in which green indicates 'positive', orange 'average' and red 'negative'. Further commentary is provided under each heading below.

	Fully licensed supplier	Joint venture	Licence lite	Partnership	White label
Ease of set up	Red	Orange	Orange	Green	Green
Start up costs	Red	Orange	Orange	Green	Green
Operational complexity	Red	Orange	Orange	Green	Green
risks	Red	Orange	Green	Green	Orange
Income generation potential	Green	Orange	Orange	Orange	Red
control	Green	Green	Orange	Orange	Red
Ability to promote local generation and set local tariffs	Green	Green	Green	Green	Red

Ease of set up

Regulatory conditions dictate that establishing a new energy supply business is burdensome and complex. The 'white label' option presents the simplest set-up option as it only requires a contract to be established with an existing supplier. The 'partnership' model requirements will be on establishing contractual terms with the existing supplier and resourcing delivery of the operational tasks it intends to take responsibility for.

Start up costs

In part due to the high regulatory burden, the set-up costs for establishing a new energy supplier are high. As there are no regulatory conditions to be satisfied under the 'partnership' model, set-up costs would be lower but investment would be needed to

establish facilities for delivering operational aspects of the business. Set-up costs under the 'white label' scheme would be negligible.

Risks

The central risk with establishing a new supply business is that it will not be profitable and ultimately go bankrupt, incurring substantial financial losses and reputational damage for a local authority as a result. The risk of failure is significant because running a profitable energy supplier is far from easy.

To succeed, a new supplier has to build and maintain a significantly sized customer base by offering competitively priced tariffs while at the same time limiting its costs. Cornwall Energy (2013) has calculated that a new supply business should only be launched if a customer base of 20,000 customers can be built rapidly. There is a particular onus on an Authority -led supplier to ensure it offers competitively priced tariffs if it is supplying low-income households.

Both the 'fully licensed supplier' and 'joint venture' options face the highest risk of failure. The reputational risk to the authority is the same for both models but the financial risk is shared with third parties under the 'joint venture' model

While exactly how 'licence lite' will operate in practice remains to be seen, the risk of outright failure by the business is likely to be substantially lower than with 'fully licensed supplier' and 'joint venture' as it should ultimately be dictated by the business health of the 'senior supplier'. However, the authority will still have some responsibility for balancing, which means there could be a risk of high costs.

The risk of outright failure under the 'partnership' model is likely to be similar to 'licence lite'. However, the risks of higher prices due to poor delivery should be significantly lower because the authority can rely on the existing trading capabilities of the third party supplier.

The 'white label' model has similar advantages to the 'licence lite' and 'partnership' models for reducing risk, but gives rise to a new set of risks because the authority has little control over the activities and operations of the supplier with which it is working.

Operational complexity

Running an energy supplier is a very complex business, with tasks including meeting regulatory conditions, trading wholesale energy, and carrying out consumer-facing activities such as billing, customer service and customer acquisition

One key advantage of the 'partnership model' when compared with 'fully licensed supplier' or 'joint venture' is that the business will be drawing on existing operational capabilities of the third party, rather than building them from scratch. This reduces risk and also produces benefits from economies of scale, for example in relation to trading capabilities, which should help to keep costs down

Income generation potential

As with all of the criteria discussed here, the income generation potential depends on how the responsibilities of meeting licensing regulations and delivering the supply business are divided between a local authority and third parties.

The income generation potential is greatest with 'fully licensed supplier', since in this model the authority is taking on all of the responsibility for the business. However, it is important to restate that running a profitable energy retailer is far from easy. The income generation potential from 'white label' is the lowest because the model involves the least direct involvement by an authority. There will be some flexibility under a partnership agreement to deliver an income stream.

Control

The 'fully licensed supplier' model offers the authority greatest control over their business because they will retain ownership of the supply licence; under the 'partnership model' a degree of control is ceded to a third party. An effective contractual agreement and relationships with the third party supplier will be required to mitigate any risks this poses. The degree of control under the 'white label' model is very limited.

Ability to promote local generation and determine local tariffs

In effect all of the models, except for 'white label', offer an authority the opportunity to support local generation projects and offer bespoke local tariffs. With the 'fully licensed supplier', 'joint venture' and 'licence lite' models, this control is integral to the authority's full or part ownership of the supply licence. In the partnership model this control should be integral to the contractual arrangement that is entered into with the third party.

Summary

A partnership model offers the best balance between risk and reward – offering opportunities to engage with our communities to reduce fuel poverty, while offering a potential income stream.

Next Steps

In May 2014 Ovo Energy announced their OVO Communities offer. This made it possible for community groups and local authorities to become partners with an Energy company in the energy supply market; removing some of the barriers to entry that had existed previously.

The main difficulty, prior to this, for a Local Authority in becoming an energy supplier is that it needed a license from Ofgen and back office functions and systems to comply with regulation. The Greater London Authority is currently progressing an application to

gain a license but only in a limited way in order to sell to other businesses the excess energy generated from the London Tube system.

The necessary requirements to become an energy supplier are complex and involve, for example, a number of IT related steps bound by regulation. This complexity has prevented new entrants from entering the market especially if they are from the community or local authority environment. Any new entrant would also need to have access to the wholesale energy market or be able to generate their own energy for sale into the market. They would also have to set up their own customer service and billing operations.

If the Council decided to take steps to become an Energy Supplier and procure a partner, a first step would be to explore the market by asking companies to express an interest in partnering with Carlisle Council in energy supply. This may also give us the opportunity to find other potential partners other than OVO Communities.

For any Energy Supply Partner, there would be clear benefits in using the trusted and reliable brand of the Council as a way of marketing their offer to residents. The key objective would be to switch new customers to their company's offer.

For the Council, the benefits of becoming an energy supplier would be that it could generate income for the local authority through selling energy which is either sourced from the Partner or that the Council has generated itself and offer help to disadvantaged groups to reduce their bills such as those on pre-payment meters.

For residents, the arrangement also would potentially provide access to cheaper tariffs and other benefits such as smart meters replacing prepayment meters for vulnerable groups who cannot access cheaper tariffs - typically 25% more expensive than tariffs found through direct debit and online. This will help people with their bills and free up household income to grow the local economy.

Currently Energy Suppliers are only able to offer 4 national tariffs, a potential partner might offer one of these tariffs for use by the Authority to market and sell to its residents. Becoming an energy supplier would also enable the Council to sell its own power into the market.

As an example of the partnership model that might be used, OVO have produced a 'Next Steps' document which is attached to this report as an appendix for illustrative purposes. OVO have also just set up their first partnership in Plymouth, a press release can be found at:

<http://www.ovoenergy.com/communities-plymouth-partnership/>

Proposed Timeline

It is proposed that we should first seek expressions of interest through a soft market testing exercise. If we are successful in attracting a prospective partner or partners it will then be possible to offer them a chance to tender to a specification. This will set out the requirements that the Council will expect of a Partner and ask them to set out their proposals and make clear their financial offer to the Council.

1. A Report to JMT seeking approval for a Portfolio Holder's Decision to allow the soft marketing exercise for an Energy Supply Partner and the exploration of the business model to take place.
2. The Soft market testing exercise is carried out via Chest (and a PIN) seeking expressions of interest from potential partners.
3. The business model and the tendering process for procuring a Partner, from those who have expressed an interest, is presented as a report to Executive seeking approval to proceed setting up the model and procuring the Partner under OJEU.
4. Subject to approval by Executive, the procurement process is begun under OJEU and the steps to establish the business model taken forward.
5. After the Partner has been procured, contractual arrangements agreed and the business model put in place.
6. Marketing of the offer to Carlisle residents.

Conclusion

Becoming an energy supplier would allow the Council to maximise the income from future generation of energy and gain an income stream.

The offer to residents would also be substantial in that we can give residents the opportunity of obtaining cheaper electricity and gas, which would reduce fuel poverty and have a significant effect on their ability to spend money both in the local economy and to manage their household budgets. We could also offer changing card meters to smart meters to some of our most vulnerable residents. This would give them the opportunity of gaining from the cheaper tariffs normally only available to direct debit customers.

This offer could also be coupled with other energy efficiency measures and services to help both improve homes and save residents money on their energy bills.

Robert Cornwall
October 2014