PURPOSE OF REPORT

This report provides an update on progress with development of an Energy Enterprise for Greater Manchester. It also outlines further areas for consideration on how to fulfil Greater Manchester’s aims and objectives in the absence of a fully licenced supply company or Joint Venture.

RECOMMENDATIONS:

The Board are recommended to:

i) Note the update on the creation of a GM Energy Enterprise and GMCA’s recent decision not to progress with a partnership (white label) Energy Company at this time; and

ii) Note and comment upon the alternative options being considered for GMCA to fulfil its aims and objectives.

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1.0 BACKGROUND

GM Officers (the GM LCPDU) have been investigating the potential creation of a GM Energy Company over the last 18 months. In June, GMCA were advised that a fully licenced supply company was not considered to be viable, however a potential partnership, via a white label model should be explored.

Subsequent investigation has resulted in a recommendation to the GMCA, in October 2016, that a white labelling model should not be pursued at this time due to the potential benefits being outweighed by the costs/risks (See Annex 1). However, GMCA noted that alternative approaches to enable GMCA to have a positive impact on fuel poverty and achieve the original aims set out for the Energy Enterprise would be explored. This paper sets out some of the options being considered.

2.0 AIMS AND OBJECTIVES

In March 2015, the Low Carbon Programmes Group commissioned an options appraisal and outline business case for the concept of an “energy enterprise” for Greater Manchester. It was proposed that an energy enterprise would inter-alia create a Fully Licensed Supply Company (FLSC) involved in the supply of energy (both electricity and gas) to industrial, commercial and domestic markets and energy purchase from the wholesale market. Also, in the case of electricity, purchase from (local) generators via power purchase agreements (PPAs).

It was intended that such a company would:

- generate revenue surpluses/provide energy cost savings;
- reduce energy costs to the fuel poor;
- encourage the development of and investment in low carbon/renewable generation in GM, by offering power purchase agreements; and
- support and encourage the achievement of socio-economic and low carbon goals.

There is still a case to be made for a GM energy enterprise to address these aims, however GMCA has now decided not to proceed with one perceived key element, a fully licensed energy supply company. The decision followed detailed work which highlighted the reputational and financial risks to the CA should it enter the licensed energy supply market, either as a FLSC or as a “white label” offering. Risks that have become even sharper as a result of a shift back towards a higher cost, more volatile wholesale energy market.

3.0 OPTIONS

GMCA’s aims are still valid; alternative routes to their achievement now need to be investigated. The following options are currently being considered:

3.1 Generate revenue surpluses/energy cost savings
a) Re-examine the potential for joint local authority energy procurement for the public estate. A number of GM Authorities are already jointly procuring their energy (e.g. Stockport, Trafford and Rochdale – through STAR). Additional potential savings could be accrued by other authorities combining their purchasing power; this is particularly true during the GMCA transition phase.

b) Consideration of a comprehensive programme of public building retrofit activity to generate operational savings, potentially using a recycling fund (e.g. using Salix finance) or ERDF grant.

3.2 Reduce energy costs to the fuel poor

There are two primary routes:

a) reducing demand/energy efficiency
   - Build on GM’s award winning Green Deal Communities pilot, with a strategic partner, to explore financial mechanisms and models for improving domestic energy efficiency, e.g. whole house approach, in hard to treat properties.
   - Working with the major six energy utilities, we are exploring their offerings around ECO3, and specifically around the new ‘flexible eligibly’ element of ECO3 which will enable LAs to determine the criteria. BEIS/OFGEM are yet to publish their guidelines, rules around ECO3.
   - Working with GM Health and Housing leads we are exploring conducting a pilot, of Bolton Council’s Home Improvement Agency (Bolton Care and Repair), working more collaboratively with GM Fire and Rescue Service (GMFRS) and their Safe and Well Check. The pilot will have the primary aim of demonstrating that the GMFRS Safe and Well Check can work as an integral part of a successful Home Improvement Agency (HIA) model, working with the HIA and other key stakeholders to assist vulnerable residents.

b) reducing tariffs/cost (particularly for fuel poor) - The largest local authority FLSCs are not delivering the cheapest tariff:
   - Explore a GM specific communications campaigns to encourage Tariff Switching Options, although national campaigns already exist.
   - Explore the potential to accelerate roll out of smart meters, potentially aligned to an energy efficiency and/or energy generation offer with a strategic partner.

3.3 Encourage the development of and investment in low carbon/renewable generation in GM e.g. by offering power purchase agreements

   - Focus on a proposition to enable a virtual private wire arrangement working with ENW, a FLSC and OFGEM, which should deliver more value to local generation supplying local demand.
   - Manchester Growth Hub has recently been awarded ERDF Funding which, inter-alia, will deliver small grants to SME’s to support the uptake of renewable energy technologies.
   - ERDF 2020 funds are being used to set up a Low Carbon Investment fund aimed at private sector low carbon/renewable energy generation projects. The initial fund will be £15m and will offer loans and equity (but not grants). The LCIF will be part of the Fund of Funds being set up by GM and will become active in 2017. A fund manager is to be appointed and will replace the Low Carbon Investment Director. The fund manager will be supported by a reduced GMLCPDU.
   - In addition DBEIS has launched the Heat Network Investment Project which aims to provide £320m of capital support to accelerate heat network
deployment across the UK. Both grants and long term low cost loans are being made available. The GMLCPDU led 3 applications to the pilot phase (2 in Manchester and 1 in Trafford). The results will be known by the end of January 2017

3.4 Support and encourage the achievement of socio-economic and low carbon goals

In addition to the above options, which could all generate socio-economic as well as environmental goals, we could consider:

- Encouraging the wider uptake of energy efficiency measures in the commercial building sector by promoting best practices and assessing the viability of competitively priced loans (e.g. thorough ERDF Low Carbon Investment Fund). A combination of the above options would support the achievement of these goals.
- As part of the Smart Systems and Heat programme, GM may need to explore with other partners, viable business models to support the commercialisation of a Home Energy Management System (HEMS) and associated energy generation and efficiency measures. This may include the creation of a Special Purpose Vehicle or ESCO.

4.0 CONCLUSION

To make a substantial change, we may need a radical shift of tactics. A number of the options above require the cooperation of a strategic partner(s) to support GM’s delivery of low carbon measures which could also bring socio-economic gains. Consideration should be given to devising a tender opportunity to attract such a partner(s) to join with GM to deliver the outcomes and benefits.
ANNEX 1

PAPER TO GREATER MANCHESTER COMBINED AUTHORITY EXECUTIVE

PART A

Date: 28th October 2016

Subject: Energy Company for Greater Manchester – White Labelling


PURPOSE OF REPORT

This report provides an update on the proposals for a Greater Manchester Energy Company (‘GMEC’) to the GMCA. Previous papers on the potential for a GMEC were presented to the CA in December 2015 and June 2016. A detailed analysis of the market position of potential White Label partners is contained in the associated Part B report.

RECOMMENDATIONS

It is recommended that the GMCA:

- Note the work undertaken to determine the appropriateness of a white label arrangement with prospective partner suppliers;

- Agree that in an increasingly competitive energy supply market, the potential benefits of such an arrangement are outweighed by the risks. As such, a potential White Labelling arrangement should not be pursued at the present time.

- Note that consideration is being given to alternative approaches which will enable GMCA to have a positive impact on fuel poverty in Greater Manchester and encourage investment in local generation assets.
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Julian Packer – GMCA (j.packer@manchester.gov.uk)

BACKGROUND PAPERS:

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1. **BACKGROUND**

1.1 This report follows the update presented to the GMCA at the June 2016 meeting. Throughout the report any reference to a fully licensed supply company is to one which is trading both electricity and gas (a “dual fuel” company).

1.2 As detailed in that report, a fully licensed supply company is not considered to be a viable option for Greater Manchester (‘GM’) given the increasing level of competition in the energy supply market and the significant associated set up costs and financial risks.

1.3 Investigations into a potential partnership via a white label arrangement with an existing licensed supplier have been made and this paper sets out the key potential benefits and risks of such an arrangement.

2. **BENEFITS**

2.1 The goals of a white label arrangement would be focussed on helping customers who are not engaged with the energy market, and are typically on standard variable tariffs with Big 6 suppliers, to move to a local energy company and realise savings on their fuel bills. Similarly it could offer savings on existing prepayment tariffs and also look to move customers away from prepayment tariffs to cheaper direct debit deals.

2.2 This is predicated on the expectation that a local energy company utilising the Greater Manchester brand could reach those so called “sticky” customers by offering a different proposition to private sector suppliers, such as by operating on a not-for-profit basis or committing to fairer tariffs. As an example, Bristol Energy in their 2016 Annual Report estimate that the 10,000 customers they have signed up to date will save a total of £830,000 per year versus staying with their existing supplier, i.e. an average of £83 per household.

2.3 A white label arrangement could also generate an income stream of commission and retention fees. However these would be offset by marketing fees and any costs directly incurred by GM to facilitate the white label model.

2.4 There is also the potential for the white label company to enter into Power Purchase Agreements (‘PPAs’). This could help stimulate investment in local renewable generation assets by providing them with certainty around the income stream they would receive for the energy offtake.

3. **RISKS**

3.1 A white label would present significant reputational risks given the use of the Greater Manchester brand.

3.2 The most obvious PR risk is around the tariffs that the white label would charge.

3.3 Under a white label the tariffs would need to mirror those already charged by the partner supplier to its customers, given the partner supplier needs to ensure it can cover its cost base by pricing appropriately. Reputationally it would also be difficult for the white label to offer a more expensive tariff given the adverse publicity it could bring.

3.4 As a result the price competitiveness of the white label is essentially driven by the pricing strategy of the partner supplier and in an increasingly competitive market place (see Appendix 1 for more details), no supplier could give assurances around being the cheapest provider on the market.
3.5 Ensuring strong customer service levels, including on-boarding of new customers, accurate and timely billing etc, would also be critical to the success of a white label. It would be challenging to get the required comfort in these areas if GM is to look at partnering with a new or smaller supplier whose systems and processes are less established.

3.6 Entering the domestic supply market also presents a significant risk around the handling of any late or non-payers. Current data shows that over last the 3 years there has consistently been c.5% of all customers whose debt is more than 90 days overdue. They are therefore a significant issue that would have to be managed by the white label and the partner supplier.

3.7 The white label could also fail to achieve the anticipated levels of engagement with local residents. The success of other local authority backed energy suppliers is still to be demonstrated.

3.8 Finally, in respect of the aim of encouraging investment in local generation assets, there is no guarantee that a white label would achieve that. Any PPAs would be under the control of the partner supplier and it would not be GM that would enter into these. That would depend on the size of the supplier’s customer base, its energy purchasing strategy, and its appetite to enter into long-term PPAs.

4. **SUMMARY**

4.1 Based on the above, it is considered that the risks far outweigh the potential benefits of entering a white label arrangement.

4.2 The market has evolved considerably since the concept of a locally owned energy company was originally put forward and there is far more competition than was the case two years ago. In addition the remedies put forward following the conclusion of the Competition and Markets Authority investigation into the energy markets, should serve to increase the competitiveness of the market further (see Appendix 1 for the details of these).

4.3 As a result any locally owned energy company is unlikely to be able to offer the cheapest deals on the market. Its key remit of seeking to reduce fuel poverty is therefore fundamentally compromised if local residents could achieve a greater level of savings by moving to other suppliers.

4.4 Reputationally a white label arrangement would present significant risks to GM, not only around the price competitiveness of the tariffs, but also around customer service levels, the handling of late payers and bad debts, and the risk of the partner supplier failing or withdrawing from the market.

4.5 There would also be no guarantee that a white label arrangement would help stimulate investment in local generation assets through the introduction of PPAs. Such aspirations can instead be promoted through vehicles such as the GM Low Carbon Fund, which will make £25m available to promote the adoption of low carbon/renewable energy technologies.

4.6 Further work is being undertaken to review alternative options which would enable GMCA to make a positive impact on fuel poverty in Greater Manchester and encourage investment in local generation assets.
Appendix 1 – Market Context

A) Current market environment – increasing competition

According to the Ofgem retail market review, published in August 2016, the Big 6 suppliers continued to lose market share in the year to March 2016, with small and medium sized suppliers accounting for 14% of the market, which represents a 4% increase during the year. For reference the market share of the independent suppliers was only 3% as recently as 2013.

Alongside this increase in market share, the number of small and medium sized suppliers is expanding with 14 new suppliers becoming active in the year to March 2016 such that there were 43 licensed and 8 white label suppliers in total at that date. That in turn followed another 5 entrants that became active in the year to March 2015.

B) Competition and Markets Authority (‘CMA’) findings & remedies

The CMA has concluded its energy market investigation and announced its proposed remedies in June 2016.

Pertinent to this report and the establishment of a white label offering, the report confirmed that there is an issue with a lack of engagement from many customers. Suppliers are in turn able to exploit this lack of engagement by charging high prices, typically through standard variable tariffs. The report found that 70% of domestic customers with the Big 6 are on such default tariffs despite typical savings of around £300 per annum being available had they switched to another supplier.

The other relevant area where a failure was found is on prepayment tariffs. There are 4 million customers on such tariffs and the report concluded that they face more barriers to change supplier than credit/direct debit customers. These result from the nature of prepayment meters, as they are constrained in terms of the number of tariffs they can offer, and the higher costs for suppliers to engage with and acquire such customers.

In light of their findings, a number of remedies have been set out by the CMA. The key measures are set out below:

Factors that should help drive competition:

- Roll out of smart meters (will improve customer engagement and competition for prepayment customers)
- Creation of a database of customers who have been on standard variable tariffs for 3 years or more to allow rival suppliers to prompt them to engage
- Price cap on prepayment customers during a transitional period (2017-20) until the smart meter roll out is complete. The cap is expected to lead to an average annual reduction in prepayment meter bills of £75 and will move every 6 months.