

LOW CARBON HUB BOARD

Date: 22nd January 2015

Subject: Energy Company for Greater Manchester

Report of: Julian Packer – Low Carbon Investment Director

PURPOSE OF REPORT

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. An energy enterprise would inter alia create a fully licensed Energy Company involved in the supply of energy (both electricity and gas) to industrial, commercial and domestic markets and energy purchase from the wholesale market and, in the case of electricity, from (local) generators via power purchase agreements (PPAs). Such a company would:

- generate revenue surpluses/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.

This paper outlines the finding of the feasibility study and proposes the next steps to develop the proposal further. This paper was presented to the GMCA in December 2015 and it was agreed that Councillor Sue Derbyshire, CA lead on Low Carbon be delegated to commission all the work necessary to develop a preferred model for a Greater Manchester Energy Company (a fully licensed supply company) for consideration of the CA at a future date.

RECOMMENDATIONS:

It is recommended that the Board:

- Note the contents of this report and the work completed by Cornwall Energy;
- Note the proposed next steps

CONTACT OFFICERS:

Julian Packer – GMCA (j.packer@manchester.gov.uk)

BACKGROUND PAPERS:

TRACKING/PROCESS		[All sections to be completed]
Does this report relate to a Key Decision, as set out in the GMCA Constitution or in the process agreed by the AGMA Executive Board		Yes / No [Delete as appropriate]
EXEMPTION FROM CALL IN		
Are there any aspects in this report which means it should be considered to be exempt from call in by the AGMA Scrutiny Pool on the grounds of urgency?		[Please state any reasons here]
AGMA Commission	TfGMC	Scrutiny Pool
Low Carbon Hub 22/01/16	[Date considered at TfGMC; if appropriate]	[Date considered/or to be considered at Scrutiny Pool; if appropriate]

1. INTRODUCTION

In March 2015, the Low Carbon Programmes Group commissioned a study into the viability of creating an Energy Enterprise for Greater Manchester (in particular the opportunity for an Energy Company), incorporating an options appraisal and outline business case. A task and finish group was established under the direction of the Director of Low Carbon Investment, a specification developed and a competitive tendering process undertaken.

Two main routes to creating an energy company were to be considered:-

- The “partnering approach” as adopted by Cheshire East for their Fairer Power company. This is a form of white labelling and is in essence a “commission-splitting” arrangement where the Local Authority fronts the entity on behalf of a fully licensed supply company (Ovo in this case) but receives modest returns and doesn’t “own” the customers which belong to Ovo in the case of Cheshire East
- A fully licensed supply company (FLSC) as adopted by Nottingham for their Robin Hood Energy Company (launched in April), Bristol (launched this month) and being set up by London (GLA – “Licence Lite”). A FLSC has full control over its trading strategy (both purchasing and retail), its margin ambitions and can create investment opportunities (particularly in local generation)

Cornwall Energy (CE) were appointed to undertake the work which is at final report stage. CE are highly regarded in the energy arena and inter alia are advising the GLA, Bristol and other local authorities in relation to their energy ambitions.

2. OPTION APPRAISAL FINDINGS

The work undertaken by Cornwall Energy (CE) found that GM has the commercial and residential scale and opportunity to potentially warrant a fully licensed supply company.

Whilst a fully licensed supply company carries the greater set up costs and operational risks than the white labelling option, if successfully delivered it could become a valuable asset for GM with returns being generated that could be targeted for reinvestment in GM priorities, and could, for example, provide an important mechanism for delivering necessary energy infrastructure and intervention in market failure around energy related poverty and poor business energy efficiency.

The CE report proposes how such a company could be created, structured, timescales and costs to establish and operate and high level projected revenues and margins over the first 5 years of operation.

The proposed structure and how the energy company could fit in with the broader GM energy landscape is shown in Annexe 1.

As can be seen, the Greater Manchester Energy Company (GMEC) would be overseen by Energy for Greater Manchester (EfGM).

EfGM is the evolution of what started out as the less well defined Energy Enterprise. EfGM is intended to be a private sector led private-public partnership which will manage GM's strategic direction with regard to energy and could encompass activities such as :-

- Investment in energy entities (such as GMEC) and in infrastructure (generation and Energy Services Companies (ESCOs) such as discrete heat network projects)
- Receive revenues from GM interests (GMEC, generation and ESCOs) and also potentially and subject to the ongoing CSR discussions, redirected energy levies raised in GM (e.g. ECO, CCL and CRC). The revenues to be invested by EfGM
- Manage other sources of investment in energy infrastructure

3. ROUTES TO ESTABLISHING A FULLY LICENSED SUPPLY COMPANY

Two viable routes to create a fully licensed supply company are under consideration. The first would be for GM to create a wholly LA/CA owned company – with attendant risk, or secondly to enter into a joint venture with a suitable partner to share risk and reduce the cost of establishment and market entry.

The cost of establishing a fully licensed supply company includes the systems required and recruiting the initial team of **16** people to operate the business at launch. It is anticipated that the timescale to reach launch is around 15 months.

The % margin of a supply business is relatively low and energy supply is essentially a volume business.. As such, the viability of the company is directly linked to its ability to scale up and achieve the required sales volumes.

With regard to scale up CE recommend a phased market entry, initially targeting the commercial sector in order to establish the business on a firm footing before entering the domestic market. The commercial market will include local authority accounts CE's high level projections indicate that the company could become viable and commence generating positive returns in the third year of operation at which point it is also proposed to enter the domestic market. Further work is required around the potential speed of market penetration and the level of margins that could be achieved.

The high level risks associated with the establishment of the energy company include:-

- Reputational risk and financial risk (development cost, collateral) should the company fail – this could be mitigated by phased market entry and creating an operational team with the appropriate experience/track record
- Set up cost budget exceeded – again this could be mitigated by detailed planning/expert advice
- Selection of inappropriate systems (e.g. CRM) – mitigated by expert advice
- Market growth projections not achieved (see above)

4. JOINT VENTURE OPTION

CE's clear recommendation is to develop a fully licensed supply company, but it would be possible to take this forward through a Joint Venture approach. This would reduce the cost, risk and particularly the timescale to achieve market entry.

The energy market is developing rapidly and there is known private sector interest in developing fully licensed supply companies. At least one company that already has commercial expertise and experience as an unlicensed supplier is in this position, and based on initial discussions is interested in exploring a Joint Venture option.

Clearly, for GM to pursue a Joint Venture option the alignment of aim between the company and GM would need to be agreed within the design of a commercial structure. There will be procurement issues to consider if this option is taken forward.

5. CONCLUSIONS

The CE report recommends that GM should proceed with setting up a fully licensed supply company.

It is proposed that this option is now explored in further detail by testing the underlying assumptions around set up costs, speed of market entry and potential operating margins, and the exposure associated with engaging in wholesale markets.

As part of this work meetings will also be held with other areas, such as London, to understand the models that are being pursued elsewhere and the drivers for those decisions.

Further work will also be undertaken to compare the potential benefits and drawbacks of the JV approach with a private sector partner as opposed to a wholly owned GMEC.

Annexe 1 Potential GM Energy Landscape

Fig 1 Schematic of the Potential GM Energy Landscape (Nov 2015)

