

BRIEFING PAPER

SUBJECT: ESTABLISHMENT OF A SOUTHAMPTON ENERGY SERVICES COMPANY (ESCo)
DATE: 15 JUNE 2017
RECIPIENT: OVERVIEW AND SCRUTINY MANAGEMENT COMMITTEE

THIS IS NOT A DECISION PAPER

SUMMARY:

The purpose of the cabinet report is to seek approval to commence a procurement and contract negotiation process leading to the selection of a preferred bidder to set up an Energy Services Company (ESCo). This will enable Southampton City Council to provide a branded energy supply product using a procured third party licensed energy supplier.

- This will help the council deliver on key outcomes; helping people live safe, healthy, independent lives, in addition to children and young people getting a good start in life. The initiative has the potential to help tackle fuel poverty, alongside a range of other initiatives.
- Equally the proposal has the potential to support the council in developing a financially sustainable future cost effective energy supply within the southern region
- Providing a low risk income
- Developing a customer base
- Providing a platform to invest further capital in further energy efficiency and generation opportunities in future phases.

The intention is for the council to earn a sustainable income from the ESCo, with estimated net income of £47k by the end of year two, rising thereafter to an estimated annual net income of £237k by end of year five.

This income will cover the costs of delivering the ESCo and potentially enable re-investment in energy services in the future to further benefit the community, within Southampton and the wider region.

The ESCo will also enable the average resident to save between £100 and £200 on their annual energy bill, which equates to up to £2 million savings for customers by the end of year 1.

Estimated set up costs are £158k. Once set up the ESCo will be self-financing.

BACKGROUND and BRIEFING DETAILS:

1. The proposed ESCo will enable the council to earn a sustainable income whilst providing a positive service to the end customer. It's anticipated that a net income will be generated by end of year two. By year five net annual income is estimated at £237k (see revenue section) and minimum average annual aggregated savings for the customers to be £4 million.

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2. The council wishes to enable fuel poor and vulnerable energy customers to be offered cost effective energy rates for the following reasons:
 - It's estimated that there are 10,000 households and 5,000 children living in fuel poverty within Southampton.
 - There are also a significant number of residents in the city that are living close to fuel poverty. This will include vulnerable children or adults we work with, SCC tenants and members of our staff.
 - Fuel poverty is linked to approximately 110 excess winter deaths every year within Southampton and major health problems associated with poorly heated homes.
 - The energy regulator, OFGEM, states that energy supply companies overcharge domestic and business energy consumers.
3. Greatest savings will be achieved by those customers that infrequently switch energy supplier or are on prepayment meters. These customers are likely to be on the highest tariffs. We aim to target this customer group.
4. The ESCo will be able capture some of the benefits locally for energy purchased within the city and beyond. It estimated that £190 million is spent annually on electricity and gas within the city of Southampton.

PREFERRED OPTION

5. It is proposed the council undertakes a progressive phased approach to deliver an effective energy supply product that will deliver the income objectives of the council and benefits for customers. This report is proposing development of Phase 1 only, whilst ensuring that we agree terms with a procured licenced energy supplier that will enable future phases to be delivered.
 - Phase 1 objectives – to provide a branded energy supply product with a third party (White Label Product – see below) to provide a low risk income, tackle fuel poverty, supply cost effective energy to all, develop a customer base and provide certainty to invest capital in the future phases. Delivery within 6-9 months from cabinet approval.
 - Phase 2 - 4 objectives – supply and sell energy generated locally by the council and our partners, develop added value business opportunities to benefit the city and local area and, if Phase 1 provides sufficient customer numbers, to develop a business case to become a licensed energy supplier and secure an energy supply license. Within 2-6 years.
6. An energy white label is an unlicensed brand that has a contractual agreement with a licensed energy supplier to sell gas and/or electricity to consumers using the white label's brand.
7. It's proposed that Phase 1 delivers a white label energy supply product that has regional coverage under a trusted local brand. This would require the council to register the brand (yet to be decided upon) under a registered trademark; then have a brand, trademark and license agreement with the licensed energy provider to

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define obligations, roles and responsibilities and any other necessary requirements. The licensed energy supplier would be 'The Company' and the brand would sit as the 'Front End' of the company locally. All back office functions and legal obligations under the energy supply regulations would be the responsibility of The Company that SCC would contract with.

8. Phase 1 means procuring an existing licensed energy supplier under a 'white label plus' or similar agreement. There are a number of models capable of delivering our requirements and these will be investigated in more detail once approval has been given to take this proposal forward. Essentially under this arrangement, SCC would not hold an energy supply licence, but would instead work in partnership with an existing licensed supplier to offer gas and electricity to consumers using our own trusted EScO brand. Initially, all back office functions would be managed by the licensed supplier.
9. An energy white label product would require around 5,000 customers to be viable. The council would aim to sign up 10,000 customers in year 1. This would be undertaken by offering low tariffs, utilising low cost existing marketing routes, direct marketing, partnering with other social landlords and raising awareness through social and other media.
10. A partner will be procured to deliver a white label EScO with a contract term of at least 5 years, plus optional extension periods up to another 5 years.

DETAIL

11. The recommended EScO arrangement can be delivered in a short timescale and offer lower cost energy tariffs to all Southampton / southern region residents whilst earning an income.
12. Income initially looks low but with increased customer numbers it can grow considerably, particularly when integrated with income earned now and in the future by the Energy Team.
13. This would be achieved by:
 - Setting up a white label locally branded energy supply company under an EScO;
 - Tapping into cheap or no cost marketing options;
 - Ensuring that the EScO's business activities are streamlined to avoid expensive bureaucracy;
 - Switching consumers to more competitive rates; and,
 - Recovering a financial rebate per supply point.

The EScO will provide other benefits including, but not limited to:

- Sustainable income for the council;
- Switching people from pre-payment meters to 'smart' pay-as-you-go alternatives;

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- Possible incorporation of the council housing current and future heat supplies;
 - Providing a route to market for local renewable electricity and efficiency schemes;
 - Providing small to medium sized businesses with a competitive alternative to the national energy providers.
14. The contracted licensed supply company will be responsible for all customer accounts and energy market regulatory compliance; whereas, the council will be responsible for marketing and promotion. This includes using our trusted brand to promote the service to all residents in Southampton and beyond, both directly and via our partners.
 15. The target sign up of 10,000 customers in year 1 would provide a minimum aggregate customer cost saving of £1 million per annum.
 16. The council are in discussions with other southern region local authorities via our existing networks and via APSE Energy. It's proposed the ESCo product will be promoted regionally across other local authority areas, which will increase market share and therefore its positive role in the energy supply market.
 17. Discussions have been held with the following existing energy suppliers Ovo, Robin Hood Energy, Bristol Energy, Community Exchange, Utilita, Tempus Energy, Energy helpline and Engie.

RESOURCE/POLICY/FINANCIAL/LEGAL IMPLICATIONS:

18. There is a requirement for further detailed assessment of the contractual content and service level agreements which will require officers, with external expert support, to conduct commercial negotiations along with the development of a full business case and legal and financial due diligence.
19. The estimated revenue costs for undertaking this detailed assessment and setting up a white label type ESCo in year one are approximately £158k, which includes officer time. Annual revenue costs thereafter would be significantly less but this requires further confirmation as part of the formal negotiation and setup of the ESCo.
20. It's proposed that the setup costs are paid from existing PUSH funding currently held to finance a Green Projects capital scheme in the Housing & Sustainability Portfolio. This money was approved to help alleviate fuel poverty and therefore aligns with the objectives of this proposal.
21. Income will be recovered from each customer supplied via the ESCo. An initial recovery rate has been used for income estimates. This figure will be agreed based on internal requirements, tariff assessment and the negotiation process with the licensed energy supplier. Any recovery rate will impact on the final price charged to the consumer; therefore, keeping the cost per energy supply as low as possible is of paramount importance.
22. Table 1 below shows estimated income SCC could achieve based on the expected customer numbers at 5 years. Income is dependent on recovery rates from the consumer tariff.

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23.

Year	Number of customers	Net Income
1	10,000	Confidential – Identified in Appendix 1 of Cabinet report
2	15,000	£47,215
3	20,000	£84,819
4	30,000	£161,395
5	40,000	£237,943

Table 1 – Example income by customer numbers

OPTIONS and TIMESCALES:

24. The decision is scheduled for 20 June 2017 following which, if approved, a procurement and contract negotiation process will commence leading to the selection of a preferred bidder to set up an Energy Services Company (ESCO).
25. Initial plans are to have a branded energy supply product able to go live in the marketplace by first quarter 2018.

Appendices/Supporting Information:

None

Further Information Available From:

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