APSE Energy Response to the Ofgem discussion paper on Non-traditional business models: Supporting transformative change in the energy market

1. Introduction

APSE - The Association for Public Service Excellence (APSE) represents council officers and members involved in the management and provision of quality public services. APSE's mission statement positions the organisation as *"networking organisation which consults, develops, promotes and advises on best practice in the delivery of public services".* APSE is currently working with almost 300 authorities within the United Kingdom. APSE members are local authorities and a small number of other public service providers. More information on APSE can be found at our website http://www.apse.org.uk/apse/

APSE Energy – APSE Energy is APSE's innovative collaboration of local authorities who are working together to deliver energy efficiency and renewable energy projects. APSE Energy is now a year old and has grown in membership to 45 councils from Aberdeen to Southampton (see the current list of members at **Appendix 1**). All of the councils in APSE Energy share the same ambition, to work together to re-municipalise energy services with local government leading the way. Our mission statement is:

"to form an effective collaboration of a large number of local authorities to enable and facilitate the municipalisation of energy services. By this we mean the public and community, as well as private, ownership and managerial control of local energy generation, distribution networks and delivery of energy efficiency works. Local authorities working together in this way would have great influence and would be able to deliver economies of scale in green energy to promote economic growth and combat fuel poverty."

There is a growing body of evidence that local authorities will play a key and important role in the transition from a centralised top down energy system based on fossil fuels, to a local distributed energy system based on renewable and sustainable energy. The Realising Transition Pathways Consortium of Universities has published important recent research pointing the way to a civic energy future (You can read their report here http://www.realisingtransitionpathways.org.uk/).

APSE very much welcomes the discussion paper by Ofgem which is a recognition that the energy market is changing driven by a bottom up 'grass roots' energy movement with the potential to create a more diverse, secure, sustainable and competitive energy market. APSE firmly believes that local authorities have an important stewardship and leadership role in this energy transition.

2. What is your view on our definition of non-traditional business models?

We think that the definition of non-traditional business models is wide enough to encompass the range of new entrants and potential new entrants into the energy market. The view that NTBM's have the potential to transform the energy market is very much welcomed. APSE believe that local authorities will play an increasingly important role in energy transition in the future, because of their local stewardship role. We define stewardship as ensuring the social, economic and environmental wellbeing of the local area, which is the principal role of the ensuring council.

In our research publication "*The road to 2020: a manifesto for the ensuring council"*[1] we make the case for the important role that local authorities will play in the energy transition: "*The Ensuring Council will have in place a strategic approach to the sustainability of local energy supplies, which advances the municipalisation and micro-generation of energy."* It is our view that Ofgem should recognise this important role for councils in the emerging energy market as a 'market enabler'.

3. How we can engage with NTBMs more effectively in the future?

Whilst the recognition by Ofgem of the role of NTBM's is welcome, in terms of engaging with the sector it is vitally important that such an approach is at a strategic level in terms of planning the energy transition in the U.K. rather than responding to market pressures and therefore the difficulties which the municipal and community energy sector have in terms of access to the market or focussing exclusively on safeguarding consumers. NTBMs should have an equivalent status with other market actors in the energy sector. Setting up an energy forum as a representative body for the sector would enable regular dialogue between NTBMs and the regulator.

We also believe that as the market opens up to a more diverse range of organisations that this will inevitably lead to the regulatory system evolving to reflect the move towards a much more distributed energy future. Local authorities are well placed to act as market enablers and aggregators in the new energy system and we would argue that councils should play a pivotal role since they have an overview of the needs of their own areas and can bring together a range of diverse interests including the private and community sectors. There are examples of European municipalities in which the public, private and community sectors play equally important roles, but this is played out at the level of municipal or regional government.

APSE Energy has been established as a representative voice for local authorities and to work with other organisations in the sector to press for change. We believe that local government should be recognised as an important partner within the NTBM sector and therefore there should be direct dialogue between the sector and Ofgem.

[1] http://www.apse.org.uk/apse/index.cfm/research/current-research-programme/the-road-to-2020-a-manifesto-for-the-ensuring-council/

4. What are the drivers for market entry?

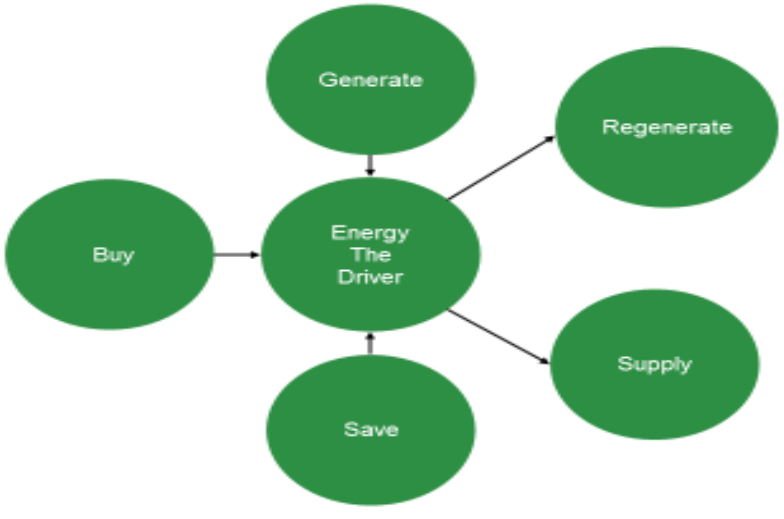
The reasons that local authorities are engaged in market entry can be summarised as:

- limited success in using collective switching schemes to benefit residents;
- the need to fundamentally tackle the issue of fuel poverty within localities;
- budget pressures and the need to drive down costs and generate new sustainable revenue streams;
- difficulties encountered in 'sleeving' power from renewable projects where the energy cannot be used on site or via a private wire arrangement;
- the significant costs of market entry and grid access;
- the potential to 'disrupt' the traditional 'monopolistic' energy market through developing local supply arrangements and emerging opportunities to offer local alternatives;
- technological advances in relation to smart grids and storage which open up the potential for distributed energy networks; and
- Longer-term ambitions around economic development, regeneration, sustainability and energy security and retaining the value from local energy projects locally rather than seeing benefit leek out of local communities and economies.

Supply is seen as a means to an end. Having local supply arrangements in place can act as a catalyst for a range of other energy related benefits which includes lower prices, greener energy, economic development and growth.

The key drivers can be described in terms of the figure below which is drawn from the work done by Peterborough City Council:

Figure 1 – Energy the driver



5. Have Ofgem accurately described the NTBM environment?

Yes broadly speaking the discussion paper summarises the main NTBM's and the motivations. It is important to recognise that in terms of municipal energy companies there are a number of different models and reasons for establishing such arrangements.

Many local authority energy services companies (ESCOs) were formed as trading bodies based on a range of energy services. The services range from waste to energy, combined heat and power (CHP) plants, district heat networks and energy saving. Examples include Aberdeen Heat and Power which is a wholly owned company of Aberdeen City Council established in 2002 as a vehicle for the development of their district heating network designed to tackle fuel poverty in the city and Yorkshire Energy Services (YES) a Community Interest Company (CIC) originally established by Kirklees Metropolitan Council to deliver a range of energy saving measures now including ECO and Green Deal, to domestic properties and to provide services to local authorities and housing associations.

Other examples include Community Energy Solutions (CES) which is a regulated not for profit community interest company (CIC) committed to helping bring affordable warmth and renewable energy to households and communities by installing low cost, low carbon, whole-house solutions. They manage large area based energy efficiency schemes incorporating traditional as well as hard to treat thermal insulation measures, heat pump and solar installations for social landlords, the private rented sector and owner occupiers. CES worked with Stockton-On-Tees Council on their Go Warm programme to deliver much needed energy efficiency measures too hard to treat properties in the private rented sector in Stockton. Originally introduced under CESP and CERT it has continued to deliver area based programmes under ECO.

Local authority involvement in ESCOs has expanded as a result of the opportunities for providing multiple energy services and as a means of market entry. For instance Blue Sky Peterborough Ltd. was established in 2011 as a wholly owned subsidiary of Peterborough City Council to facilitate investment and development of renewable energy generation projects as well as energy efficiency initiatives. It is an aggregator of energy services and is a vehicle both for commercial trading and realising the value and benefit of a range of energy services (**see figure 1 above**) both for Peterborough and the wider local government community though OJEU compliant framework contracts for Energy Performance Contracting (EnPC) and Solar PV installations.

Some local authority wholly owned companies which were originally not established for specifically energy related purposes, but with the intention of commercial trading have subsequently become energy services companies. An example of this is Swindon Commercial Services the ALMO of Swindon Borough Council that undertook solar PV programmes for social housing and public buildings and developed a waste to energy plant (refuse derived fuel – RDF). The company is now called Public Power Solutions Ltd. and has set up a national framework to deliver ground mounted solar PV schemes for the public sector. Similarly the arms-length company of Norfolk County Council (NORSE) has moved into energy services by way of wider commercial trading.

One of the most significant developments however, is the creation of specific supply companies of which there are essentially three types:

- The first is the **'virtual energy company'** which is a form of white labelling and is associated with the OVO Communities offer to councils, housing associations and community organisations. This is where OVO offers its platform to councils and others to provide local tariffs with a range of other potential benefits to get customers to switch. It is primarily built around the trust that local authorities have as a means of attracting new customers. A number of councils and community organisations have set up such arrangements including Cheshire East Council and Southend Council.
- The second variant is the **'municipally owned energy company**' which is a wholly owned local authority supply company based on licenced supply in a box. The two councils most notably associated with this approach are Bristol and Nottingham. Nottingham have set up a subsidiary company called 'Robin Hood Energy'. The primary aims of such an approach is very much modelled on the European model of 'Stadtwerke' where the council takes a leading role and it is driven by social, economic and environmental priorities in particular tackling fuel poverty in communities. But the creation of such a platform allows local authorities to scale up energy services including generation projects to provide enhanced community benefits and in order to raise revenue from providing services to local residents and businesses.
- The final variant is the **'Co-Operative or non-profit distributing company'**. This model has developed within the housing association movement and is built on customer volumes and scale. The best example of this approach is 'Our Power' which is a consortium of housing associations mainly based in Scotland with the aim of tackling fuel poverty. They have created an Industrial and Provident Society (IPS) model to support social housing tenants, but it is also potentially a platform for renewable energy generators to access the market by way of PPAs. The key distinction between this variant and the wholly owned municipal company although they both share similar ambitions is that the approach is regional or even national whereas the municipal energy company is about benefit to a defined community or area.

There is clearly potential based on customer volumes and wider community benefit for municipal energy companies to operate on a consortia basis or provide a 'trusted' platform for other councils seeking to maximise the benefits of local energy services. There is also potential to develop another variant with a private sector partner which is neither just a 'white label' nor 'licence lite'. This is still very early days but provides in our view a unique opportunity both to shake up the energy market, provide a route to market for civic and community generators and create a platform for future distributed energy networks.

6. NTBM's within current regulatory arrangements – issues arising for local authorities

We wholeheartedly agree with the statement in the discussion paper that *…"supply is mostly delivered by a small number of vertically integrated companies. In addition, the broader regulatory framework, including the current system of code governance, can act as a barrier to*

pro-competitive innovation and change, as identified by the CMA in their ongoing Energy Market Investigation."

The current structure of the industry and the way in which it is regulated can both inhibit market entry and impose costs on small generators and suppliers that can make it highly uncompetitive. Whilst we support attempts to streamline the regulatory environment through initiatives such as 'Licence Lite', it does not appear to us that this offers a credible and cost effective means of market entry for small generators and for municipal projects.

An example of how the current system can impede new projects can be seen from Flintshire County Council. Flintshire want to develop a small 5MWp ground mounted solar farm on land owned by the Council as part of a joint venture with a solar developer. If the Council offers the land then it would only receive a small income from the ground rent. However, if the Council was able to 'sleeve' the power for use in its own buildings then that would be an advantageous commercial arrangement. The offer of a Power Purchase Agreement at 5.8p per KWh would be attractive, but when all the elements of a standard Electricity contract e.g. Transmission costs, (TuoS), Distribution costs (DuoS) and a Balancing charge (BSuoS) are levied then the project itself is uncompetitive with other current supply arrangements, thus defeating the object of the exercise in the first place.

Other issues for generation projects arise as a result of the costs of network connection. There are currently in many areas of the country grid capacity and connection issues for commercial, municipal and community schemes. Ofgem is consulting separately on quicker and more efficient distribution connections and APSE has responded separately to that consultation. However, the cost of grid connection and access to the grid in many areas of the country is a major issue for many local authorities.

Another example of structural issues can be seen in one of our local authorities in England that is installing solar PV on our new build social housing. The model they have adopted is that tenant will get the free electricity and the Council will take the FiT. However, a problem arises in that the incumbent supplier British Gas will only give the FiT to the Council as long as the tenant stays with them for their dual fuel. This is something the Council cannot control. Ideally the Council would like to find an energy company that will offer the FiT on an ongoing basis regardless of the tenant's supplier. There are two issues here:

- The Council would rather have a supplier, for administrative simplicity, that is prepared to carry on paying the FiT regardless of who the tenant is using for energy supply.
- In most cases the Council would not know if and when a tenant switches, which appears to be an inhibitor to generating energy on the rooftops of social housing.

These are just some of the examples of the problems faced by municipal energy schemes within the current industry and regulatory environment. It is one of the main reasons that local authorities are keen to explore new supply platforms as a means of market entry including wholly owned supply companies or hybrid solutions.

There is still a major difficulty for many local authorities in terms of entering the supply market. There are a number of inhibitors which can be summarised as:

- Prohibitive costs and complex regulatory framework around becoming an energy supplier;
- Lack of specific expertise in the wholesale and retail energy markets;
- The need to have customer volumes and scale in order to support market entry and provide longer-term viability; and
- Concerns about risk where public money is used to support a new venture where the returns and community benefits maybe longer-term.

Some local authorities will have both the ambition, political and corporate will and potential to become suppliers in their own right or to enter into arrangements with other licenced suppliers in order to provide a platform for local energy schemes. But this to a large degree depends on customer volumes, appetite for risk and capacity. This is not therefore currently something which many councils could undertake.

However, changing the regulatory environment to encourage local innovation and market entry and to reduce both the cost and risk involved would in our view be hugely beneficial in assisting the energy transition and would create a more diverse and competitive supply market.

7. How could NTBMs potentially transform the energy market and what fundamental challenges to regulatory arrangements could this entail?

How could regulatory arrangements change to accommodate NTBMs?

What role do NTBMs and other parties have in managing energy market transformation and regulatory change?

It is our view that NTBMs have a great potential not only to disrupt the current energy market, but to transform it in various ways. This appears to be recognised within the Ofgem discussion paper. To move towards a distributed energy future requires new institutional architecture and a different regulatory environment. In the current energy market it is difficult to see how certainly in the short-term, NTBMs can compete on a 'level playing field' with incumbent providers and therefore it should not be judged or evaluated based on a static state basis. If this is seen purely in terms of market driven benefits to consumers rather than as one of the means of transforming the market, then from the point of view of the existing regulatory arrangements, it may not meet certain tests relating to competition and consumer benefit.

This is much more akin to business incubation and it requires support to develop and flourish, rather than being exposed to regulation within the current market environment. As pointed out within the discussion paper, NTBMs can potentially bring much wider social, environmental and local economic benefits.

We support the headline message in the report of the Realising Transition Pathways Research Consortium *"Distributing Power: a transition to a civic energy future"*[2] that:

"In order to move to a distributed approach, regional energy strategies and local capacity building will be essential for city regions, municipalities, communities, and citizens. This means complementing our national energy planning with regional and local support for a civic energy sector. This may mean a system of transmission level capacity auctions and contracts and regional level energy strategies and regulation."

One potential scenario for future regulation is identified in the report as:

"A new civic energy sector means that regulatory structures would change from pure regulation to a regulate and support function. We propose a dual approach within 'Ofgem+' wherein Ofgem continues to regulate national transmission level generation and national competitive supply, but where the new LESs and ESCOs are supported by a Regional Energy Partnership (REP)."

8. Conclusion

APSE believes that the Ofgem discussion paper is a useful starting point for an ongoing dialogue with regard to the changes to the energy market which are already happening as a result of NTBMs. We believe that local authorities have the potential to be both:

- **Market enablers** – providing the institutional architecture and platform through which NTBMs can both access the market and in order to scale up local distributed energy solutions; and
- **Infrastructure investors** – Providing a vehicle for major investment in local energy infrastructure either by way of public, private or community sector means.

This is a constantly changing and evolving environment and whilst the Ofgem paper describes this in clear and coherent terms, it will continue to develop and will therefore need nurturing and support. In the short-term there is a need for the regulator to respond to remove some of the current barriers for NTBMs, but in the longer-term there needs to be a strategic framework put in place which both recognises the upsurge in the market and is designed to reflect the energy needs and demands of the U.K. for the foreseeable future.

APSE would be more than happy to work with Ofgem and to provide both case studies and contacts within local authorities which Ofgem can follow up as part of their ongoing work.

Mark Bramah
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[2] http://www.realisingtransitionpathways.org.uk/realisingtransitionpathways/publications/FINAL_distributing_power_report_WEB.pdf

Appendix 1 – Members of APSE Energy

Name of Council	Region
Aberdeen City Council	Scotland
Barnsley Metropolitan Borough Council	Northern
Bradford Metropolitan District Council	Northern
Bridgend County Borough Council	Wales
Buckinghamshire County Council	South/South West
Cardiff City Council	Wales
Cumbria County Council	Northern
Darlington Borough Council	Northern
Derbyshire County Council	Central
Doncaster Council	Northern
Dudley Metropolitan Borough Council	Central
East Dunbartonshire Council	Scotland
East Riding of Yorkshire	Northern
Edinburgh City Council	Scotland
Fife Council	Scotland
Flintshire County Council	Wales
Gedling Borough Council	Central
Glasgow City Council	Scotland
Gloucestershire County Council	South/South West
Guildford Borough Council	South/South West
Knowsley Metropolitan Borough Council	Northern
Lancaster City Council	Northern
Middlesbrough Borough Council	Northern
Midlothian Council	Scotland
Newcastle City Council	Northern
North Ayrshire Council	Scotland
Nottingham City Council	Central
Nottinghamshire County Council	Central
Northumberland County Council	Northern
Oxford City Council	South/South West
Peterborough City Council	South/South West
Portsmouth City Council	South/South West
Preston City Council	Northern
Reading County Council	South/South West
Sefton Metropolitan Borough Council	Northern
Selby District Council	Northern
Southampton City Council	South/South West
South Lanarkshire Council	Scotland
Stevenage Borough Council	South/South West
Stockton-On-Tees Borough Council	Northern
Swansea City and County Council	Wales
Wakefield Metropolitan Council	Northern
Warwickshire County Council	Central
Wolverhampton City Council	Central
York City Council	Northern