

‘Collective Switching’ of Energy

Purpose of report

The purpose of this report is to seek the Leadership Board’s views as to whether the LGA should become involved in collective switching, and if so, at what level.

Summary

Collective switching of energy supplies is a process whereby consumers band together into a sufficiently large group to arrange a ‘reverse auction’ with energy suppliers.

The LGA Leadership Board in May 2012 received a presentation from a Belgian company, iChoosr, who organise collective switches for consumers, and have asked for a report back. In particular, the Board wish to consider whether the LGA should take a direct role in assisting its Members in this field.

The report sets out a number of issues that warrant consideration before deciding whether to proceed.

Recommendation

The Leadership Board is asked to consider the options as set out in paragraphs 33-35 and determine a preferred way forward.

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‘Collective Switching’ of Energy

Background

1. The domestic energy market in the UK is large and complex with over 20 suppliers, 14 energy regions and approximately 98 different customer bill tariffs. The market is dominated by ‘the big six’:
 - 1.1 British Gas (11 million customers)
 - 1.2 E.ON (9 million customers)
 - 1.3 Scottish and Southern Energy (8 million customers)
 - 1.4 NPower (7 million customers)
 - 1.5 Scottish Power (5 million customers)
 - 1.6 EDF Energy (5 million customers).
2. Combined these companies hold over 99 per cent of the UK domestic energy customer base.
3. Department for Energy and Climate Change (DECC) figures released in June 2012 show that there has been a gradual decline in the number of households switching supplier. From a peak in 2008 of around 1.5m electricity customers switching, the market is now seeing around 750,000 switching, and around 500,000 gas switchers from a peak of over 1.1m customers in 2008 (see **Annex 1** for monthly switching trends).
4. With the reduction of transfers, multiplicity of tariffs, and dominance of ‘the big six’ suppliers it is increasingly likely that many customers are not getting the best price available for their energy requirements.
5. DECC are also concerned with what appear to be substantial sector profits at the same time as price increases to consumers. In July, for example, British Gas announced a 23% increase in profit to £345m at the same time as domestic energy bills rose on average by £90 per household. In response to this position DECC wish to make the domestic energy market more competitive and ensure value for money. One area being looked at is collective switching. A DECC collective switching board has been set up which already has LGA representation.
6. The Department for Communities & Local Government (DCLG) are taking a wider interest in local government’s energy consumption from an efficiency perspective, and plan to hold an ‘Energy Summit’ later in the year. The LGA has provisionally agreed to support this initiative. The sector already has a number of collective purchasing arrangements in place, such as Laser hosted by Kent CC on behalf of 72 south-eastern councils. Whilst collective purchasing is distinct from collective switching, the increasing focus on rising energy costs is a common concern.
7. Collective switching of energy supplies started in Holland and Belgium in 2008. To date over 1 million customers in the Low Countries have switched using this initiative to get cheaper energy. The aim of collective switching is that consumers join together to form a sufficiently large purchasing group to attract serious interest from energy providers, who in turn will offer low prices to attract them to switch. It is usually organised by a

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'switching company' who work to build up a base of interested customers and then hold a form of 'reverse auction' with suppliers to obtain for customers the cheapest possible price. Once a price agreement is reached with suppliers the switching company will then arrange for the customer transfer.

8. The first major UK collective switch took place in June this year, and was organised by Which? Some 37,000 out of 95,000 people (who signed up to the scheme with correct information) switched either or both gas and electricity supplies. Customers who switched using this scheme saved £8million in total, and on average £223 pa per household.
9. In recent months several councils have also started working in partnership with collective switching companies to promote schemes, these include Cornwall County Council (via Cornwall Together), South Holland District Council, South Lakeland District Council and London Borough of Tower Hamlets. All council schemes are currently at an early stage of signing up interested customers and no auctions have yet taken place.
10. LGA Officers have spoken with several 'players' in the collective switching market to see if the LGA could have an involvement in such schemes and what this might involve. Discussions have taken place with:
 - 10.1 **iChoosr** – A Belgium company who are the leading collective switching company in Belgium and Holland. iChoosr are keen to enter the UK energy market, and presented to the LGA's Leadership Board in May this year.
 - 10.2 **Which?** – A UK based company who ran the UK's first major collective switching initiative 'The Big Switch' earlier this year.
 - 10.3 **The Peoples Power** – A word of mouth and social networking initiative to create interest and sign up people to collective switching, with a particular emphasis on hard to reach groups.
 - 10.4 **Cornwall Together** – Cornwall County Council's collective switching partnership with the Eden Project, and uSwitch
 - 10.5 **uSwitch** – UK's largest dedicated domestic energy switching site and provides the technical support and will run the reverse auction with energy suppliers for Cornwall Together.

The issues

The Model

11. From the discussions held a fairly standard model has emerged; there are 3 main components required to run a scheme:

11.1 Switching Specialist – They are responsible for ensuring that the legislative requirements of switching are complied with, and setting up and running the 'reverse auction' with energy suppliers. They will typically run a customer contact centre to provide support to people interested in switching. In most cases this is a switching company specialist such as iChoosr, uSwitch, or Which? The switching company funds this activity from a referral fee paid by the successful auction winner – see 13 below. They are quite likely to engage a specialist energy consultant.

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11.2 Marketing Specialist – Their key responsibility is the promotion of the scheme: publicity, production of marketing material, etc. They are the driver for ensuring people are aware of the scheme to sign up to. The Which? 'Big Switch' scheme was marketed by the campaigning group 38 Degrees.

11.3 Local Leadership – Local leadership is vital to any scheme to promote trust with the public. This is the role that either the LGA or councils involved would provide. This would involve the council/LGA being the brand lead for the scheme. It could also involve council facilities, events and staff to sign up people to schemes and using local leaders/councillors as public faces of endorsement.

12 The process for a full switch is complex and will take around 4-6 months per switch and involve several phases:

Phase 1: Council to decide its purpose for being involved in a scheme. This could be one or several of the following:

- To achieve savings for its residents on energy bills
- To promote competition in the energy market
- To promote green initiatives or green energy
- To promote user behavioural change (e.g. energy efficiency)
- To promote cheaper energy to hard to reach groups and those in fuel poverty
- As a revenue generating operation, with the intention of making a profit
- To respond to the Home Energy Conservation Act 1995 and to fulfil councils statutory duty to assist in reducing domestic energy consumption.

Phase 2: Procure a switching specialist and marketing specialist

Phase 3: Build up a base of residents interested in switching. To do this a registration period is set up usually lasting between 6-8 weeks. During this period promotional work is done, fronted by community leaders with the aim of getting at least 10,000 people to sign up to show their interest in switching suppliers.

Sign up is either done by registering on a website or by a paper based process for those who do not have internet access. People interested in switching will be asked to provide information on their energy supplier, payment method, and energy consumption as part of the sign up process.

Phase 4: At the end of the registration period the switching specialist will approach energy suppliers and hold a 'reverse auction' to negotiate a best price for energy should the customers transfer to them.

Phase 5: Once agreed, customers will be notified individually via a personalised offer containing details of savings they could make and an offer to transfer. It is then up to the customers individually to decide if they take up this offer and they will be put in direct contact with the energy supplier to transfer if they so choose. Suppliers usually allow a 4 week window for customers to transfer their supplier; if they do not sign up within this period then the offer is withdrawn. The rate offered in Phase 4 above is not affected by low customer transfer numbers.

Referral fees:

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13. A referral fee is paid by energy suppliers for each customer that transfers to them. The fees advised in most cases are approximately £20 per fuel (£40 for dual fuel) for each customer transfer. However, our discussions highlighted a range from as little as £2 to £40 per customer. This fee is usually paid directly to the switching specialist with councils and other partners receiving a fee from the switching specialist to cover their costs and any council driven fuel poverty or energy efficiency schemes to support their residents.

Numbers of switchers required:

14. To obtain energy supplier interest in a collective switch, a figure of between 10,000 – 30,000 switchers is considered necessary. As this figure is large it may be sensible to look at the option of several councils running schemes in tandem and their pool of customers together to get the required numbers. It should also be noted that in schemes in Holland and Belgium, only around half of those who sign up for collective switching actually transfer; in Which?'s Big Switch initiative 37,000 out of 95,000 people who signed up transferred.

Lessons Learned

15. The first UK collective switch has not persuaded energy companies to lower their current prices. Customers have obtained a cheaper tariff, but that tariff is one that is currently available within suppliers' pricing structures. Energy companies have preferred to offer various 'eco' and energy efficiency measures in addition, rather than compete around the basic cost of energy.
16. Which?'s 'Big Switch' initiative did not attract any of the top six energy suppliers because of re-contact embargoes. The energy companies were not prepared to have customers they had 'purchased' re-approached 12 months after the switch, and Which? were not prepared to sign a contract that prevented them from doing so. The collective switch took place with Co-operative Energy who have less than a 1% share of the market.
17. Collective Switching is not cheap or simple to do. The LGA, or any council, would need to work with a switching specialist who has knowledge of the energy sector. iChoosr made an investment of over €1 million in IT infrastructure, help lines, technical specialists and marketing. Which? invested approximately £0.5 million in these areas. The amount of any referral fee the LGA might be able to negotiate will depend upon the extent to which these costs have already been sunk, and can therefore operate on the marginal cost.
18. Councils and the LGA's role in local leadership will be crucial in the success of any scheme. The energy market has been subject to many incidents of mis-selling to customers. The LGA's reputation and credibility would be central in driving engagement and trust with local communities. Clarity of purpose (para 10, Phase 1, above) is critical.
19. So far, all councils involved in collective switching agreements have not done so to make a profit from the schemes. Councils have taken back small percentages of

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switching fees received to cover their costs and set up energy efficiency or fuel poverty schemes to help vulnerable residents.

20. Evidence from switching companies suggests that collective switching is not appropriate for business users, such as councils. High consumption organisations are able to either directly negotiate a better energy price with suppliers, or to form partnerships to do the same thing. As mentioned in 4 above the sector is already reasonably well placed here, with for example, organisations such as Laser, hosted by Kent CC on behalf of 72 councils, and the London Energy Project hosted by Haringey on behalf of 32 London boroughs.
21. Members will be receiving a report on centralised/collective purchasing for councils, which is likely to include energy purchasing, later this autumn; this work has been led by Andrew Smith, CE of Hants CC, on behalf of the LGA.

LGA's Role

22. It is important to agree the purpose and objective of any LGA involvement in collective purchasing before starting any scheme. Crucially is the scheme going to be used to make a profit for the LGA? If so, a further consideration might arise: should, and how, will our members benefit from any profit?
23. It would be important to agree how the LGA is involved in running collective switching. Due to the importance of local leadership and trust with residents in any scheme, member councils need to play a role at a local level. A workable model could be:
 - 23.1 the LGA procures one or more switching specialists that its member councils can work with if they want to run a collective switching scheme;
 - 23.2 the LGA then arranges for the switching company and their marketing experts to organise groups of councils to achieve a cohort of 10,000 – 30,000 switchers (ie c30-80,000 registrations) from across several councils;
 - 23.3 the LGA then liaises with the switching specialist to run the 'reverse auction' with suppliers;
 - 23.4 the switching company advises customers of the deal obtained on their behalf; any deal is then made between the customer and the winning energy supplier.
24. This role means that the procurement of a switching company(ies) is made only once by the sector, removing the cost of multiple procurements by the sector – a clear benefit to LGA members. Involvement at this level would require one additional FTE post, probably around the Grade 7 level.
25. At a lesser level, the LGA could consider promoting the benefits of collective switching, and the work of existing councils in this field such as Cornwall, South Holland, South Lakeland and Tower Hamlets. This could take the form of arranging for a Third Party to provide a procurement framework from which councils could call off a switching specialist, highlighting the issue on our website, use of the Chairman's letter, a conference of switching companies and leading councils, etc. This role could be assimilated within existing staff resources.

Procurement

26. The LGA has sought advice from specialist lawyers in relation to the procurement of collective switching schemes. The advice is set out in paragraphs 27-28 below.
27. Two main options are available to protect the LGA's position and reputation: firstly, to find an existing framework from which the LGA and/or its member authorities can procure supplier(s), or secondly, set up such a framework for that specific purpose.
28. If there is a relevant existing framework for the CP Scheme which covers the LGA's requirements and is available to the LGA, then a call-off contract may be awarded either by direct award of a contract or by mini-competition in accordance to the terms of that framework.
29. A collaborative approach to procurement by the LGA on behalf of or together with other member councils may share procurement costs and jointly realise benefits from aggregated demand. The LGA may set up and host a framework for the provision of the scheme. As a hosting authority, the LGA may recover an administration fee for managing the framework. Provided the framework agreement is procured in accordance with the Regulations, this would permit participating authorities to award relevant contracts to residents without conducting a full tender process.
30. The Government Procurement Service (GPS) have confirmed that no such framework currently exists. Officers are in discussion with a number of councils looking to procure switching companies to see if their EU Notice can be used, but currently this seems unlikely. Discussions continue with the GPS as to them establishing a framework. However, if it is necessary for the LGA to set up its own framework, this is likely to take approximately four to six months, and discussions with the LGA legal team advise that there will be a cost of approximately £30,000 to do this.

Risks

31. The main risk to the LGA is reputational: procuring a collective switching partner properly; ensuring no mis-selling; successfully obtaining a sufficient size cohort of switchers; etc.
32. Collective switching is a very new initiative in the UK and there are only limited examples of successes and failures in the field.

See **Annex 2** for more detail.

Conclusion and Recommendations

Options

33. One option for the LGA is to “note with interest” the developments in the energy market with regard to collective switching, and see how the schemes progress in Cornwall, South Holland, South Lakeland, Tower Hamlets, and others as they emerge.
34. A second option could be the “Promote+” option as set out in para 25 above. This option would be cost neutral to the LGA.
35. The third option is more direct involvement as described in para 23 above. There are costs of doing this (c£30,000 for the procurement costs and the cost of a Grade 7 post, perhaps on a one or two year contract) but these should be recoverable from the referral fee of a successful switch. It would be a clear benefit to LGA members as each one is likely to face procurement costs similar to those of the LGA. There are very clear benefits to citizens in any collective switch, but arguably these are best/most appropriately secured by the relevant local authorities. A further consideration in this option is whether the LGA should seek to make a profit by becoming directly involved.
36. The benefits to the LGA of becoming directly involved in collective switching seem slight. The risks could be broadly categorised as ‘low/moderate likelihood’ but ‘moderate/high impact’. In short, direct involvement is a finely balanced judgement, and Leadership Board’s decision is sought.

Financial Implications

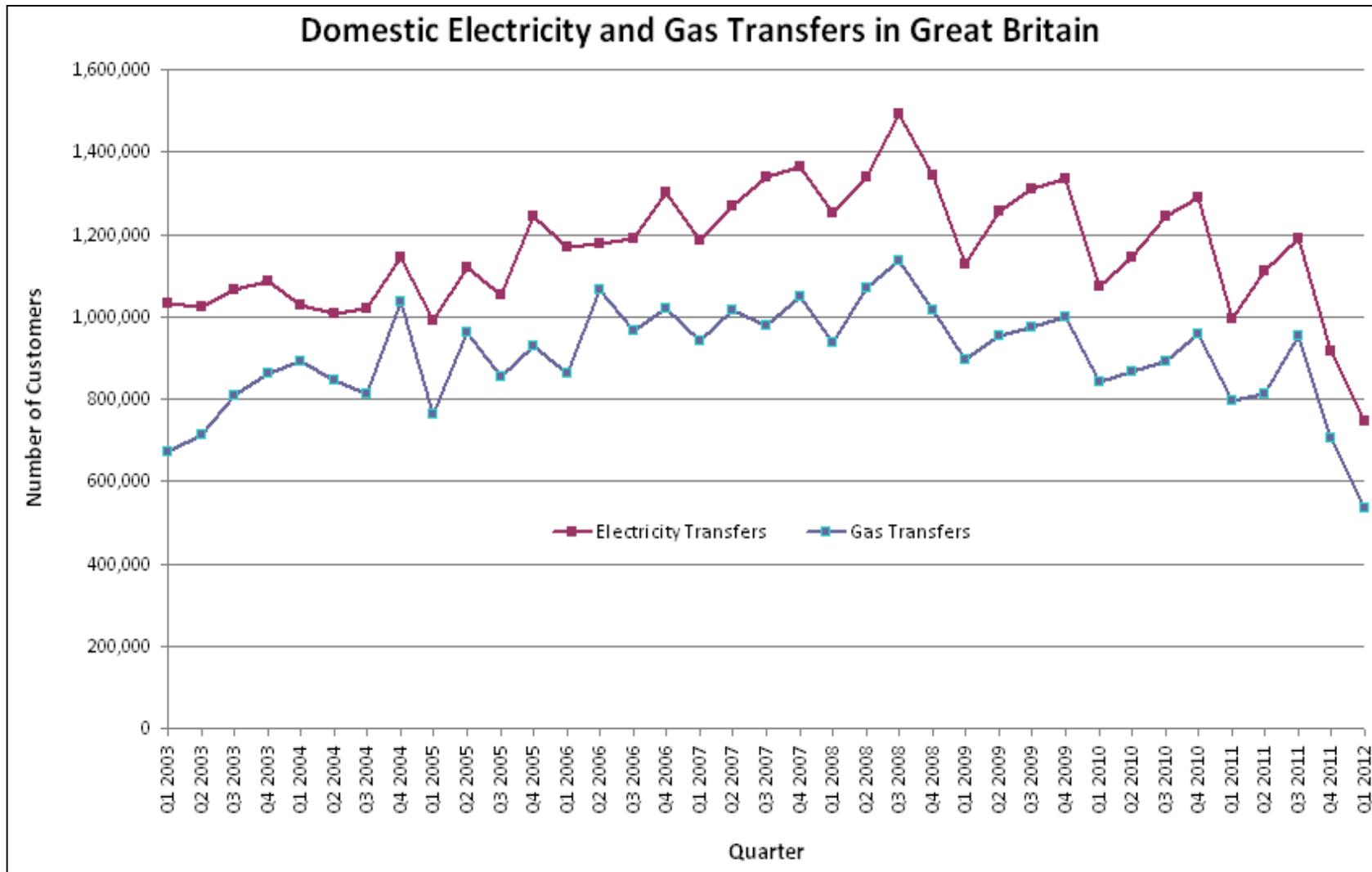
37. To become directly involved in collective switching could require the LGA to invest around £80,000 - £100,000 but it would be expected that this sum would be fully recoverable from the referral fees of a successful switch.

Appendices

Annex 1 – Monthly switching trends 2003 to 2012

Annex 2 – Summary of risks and Benefits

Annex 1 - Monthly switching trends 2003 to 2012



Annex 2 - Collective Switching – Benefits and Risks to the LGA

Benefits	Risks
Enhances LGA membership offer to councils.	Risk to the LGA's reputation and credibility: <ul style="list-style-type: none"> • procuring a collective switching partner properly; • ensuring no mis-selling; • successfully obtaining a sufficient size cohort of switchers (c30-50,000 registrations); • Failure to obtain a sufficient share of the referral fee.
If the option of the LGA procuring a switching company is taken forward it will remove procurement costs from the councils doing this individually.	Risk to LGA member authorities reputation and credibility: Local leadership is key to driving the success of a scheme:
Running a scheme should be cost effective: any staff and set up costs could be recovered by taking a percentage of the switching fee given by suppliers when a transfer is made.	Collective switching is a very new initiative in the UK and there are only limited examples of successes and failures in the field.
If the schemes are successful they could help promote local leadership, local councils and LGA brands	Collective switching partner becomes insolvent
	Lack of interest from the 'big six' energy suppliers who control the majority of the market between them.
	Entering the collective switching market without a clearly defined purpose could lead to any scheme being unsuccessful.