Portsmouth
CITY COUNCIL

Title of meeting:	Cabinet
Date of meeting:	29th July 2017
Subject:	Establishment of a Joint Venture Municipal Energy Supply Company
Report by:	Director of Finance & Information Services (Section 151 Officer)
Wards affected:	All
Key decision:	Yes
Full Council decision:	No

1. Purpose of report

1.1. To consider the Outline Business Case for the establishment of a licensed energy supply company between Portsmouth City Council and a joint venture partner as a part of the Council's energy strategy.

2. Recommendations

It is recommended that:

2.1 The Outline Business Case (Exempt Appendix 1) and the operating model contained therein is approved.

2.2 Subject to recommendation 2.1, delegated authority be given to the Director of Finance & S151 Officer, in conjunction with the Leader of the Council to approve the Final Business Case subject to the milestones and gateways (set out in the Outline Business Case) being successfully achieved with a maximum investment payback period of 4 years, provided that any changes between Outline Business Case and Final Business Case (each of which shall include a Base Case) do not, in the opinion of the Director of Finance and S151 Officer, materially change either the amount of investment required or the level of financial and reputational risk that the Council will be exposed to.

2.3 That the investment required from the City Council to support the capital investment and working capital requirements of the Energy Supply Company be funded from the MTRS Reserve.

2.4 Delegate authority to the Director of Finance & S151 Officer, in consultation with the Leader of the Council, to conclude the terms of the agreement with the Joint Venture partner (including equity arrangements, security arrangements and exit arrangements); once concluded, authorise the City Solicitor to enter into such company constitutional, and associated and ancillary documents as required.

2.5 Subject to the approval of a Final Business Case, authority be delegated to the City Solicitor to form the Joint Venture company and associated relevant corporate structures that will best serve the objectives of the licensed energy supply company as described in this report and the Outline Business Case in order for the company to progress into Controlled Market Entry and subsequent full launch.

2.6 Prior to the establishment of the Joint Venture company and associated Corporate Structures, a Governance Board is established to guide the delivery of the Final Business Case, approve associated milestones and gateways and oversee overall progress; the Governance Board to be chaired by the Leader of the Council and comprise the Director of Finance & S151 Officer, the Joint Venture Partner, an Energy Consultant and the City Solicitor or his representative.

2.7 In the event that any contractual arrangements or other assurances are necessary for the smooth implementation with third party suppliers prior to the establishment of the Joint Venture company and associated Corporate Structures, that the City Solicitor, in conjunction with the Director of Finance and S151 Officer and the Leader of the Council, is authorised to enter into any such agreement.

2.8 Delegate authority to the Director of Finance & S151 Officer, in consultation with the Leader of the Council, to liaise with Office of Gas and Electricity Markets (OFGEM), Department of Business, Energy and Industrial Strategy (BEIS) or any other statutory or regulatory body necessary for the formulation or functioning of the Joint Venture Company.

2.9 To delegate authority to the City Solicitor, Director of Finance & S151 Officer, in consultation with the Leader of the Council to establish appropriate Council-side shareholder oversight arrangements.

3. Background

3.1 The Energy market in the UK is heavily regulated by the OFGEM with Policy set through BEIS. The market is undergoing rapid change but is dominated by the Big Six Energy suppliers which hold 80% of the market share. There are 52 other energy supply companies holding the remaining 20% of market share.

3.2 The domestic energy supply market is currently characterised by:

- Rising real terms prices for consumers;
- Low levels of customer satisfaction;
- Increased scrutiny of Energy Suppliers pricing activities;
- More active number of customer switches (7% of the total market in 2017 and rising at around 14% per year);
- Growing numbers of new entrants; and
- A significant interest nationally from local authorities seeking to enter the market as Municipal Energy suppliers.

3.3 At present, just 2 Local Authorities have established their own fully licensed energy supply company, Nottingham City Council (2013) and Bristol City Council (2015) although others exist as a "White Label"[i1] but are not fully licensed. Other Local Authorities such as Birmingham City Council have announced their intention to enter the market and more locally, Southampton City Council has announced its decision to open up a competition to partner with a licensed supplier under a "White Label" arrangement.

3.4 Wider Government policy on Energy as a whole is centred around the following 3 key objectives:

- Affordability for customer;
- Carbon reduction (Energy efficiency); and
- Security of supply.

3.5 Increasingly, Government are looking to more local models to achieve these objectives, either through "disrupting the market" with new competition but also recognising that prescriptive national policy cannot effectively address the energy needs of every locality. For example, the energy efficiency of the local housing stock and their nature will differ from place to place, equally the extent to which local energy generation (for example through local heat networks and combined heat and power units) and private / self- supply will also differ. There is significant disparity between different localities now in relation to both energy efficiency and therefore energy cost. Current and emerging technology supports local energy generation and such investment is patchy across the country. Future Government initiatives therefore, are expected to be more tailored to local circumstances with national policy direction being a "principles based" approach with non-prescriptive local interventions.

3.6 In the future, it is widely accepted that as the cost of renewables such as solar and wind continues to fall this will evolve into the development of 'micro grids', whereby local demand and supply will become self-sufficient.

[1] A simplified and quick route to market. A fully licenced supplier offers a white label offering to another partner. The partner develops its marketing proposition and sells direct to its target customers, whilst the licenced supplier provides all the market related services, billing and customer service

3.7 The combination of policy direction, new technology (such as remote control over energy usage for both domestic and non-domestic customers and the advancement of battery storage for energy), reducing cost of renewables, local micro energy generation and low levels of customer satisfaction creates significant opportunities for fully licensed energy supply companies that provide services throughout the energy generation to energy supply chain.

3.8 Locally, the Council's Energy Strategy seeks to improve energy efficiency and make energy more affordable in order to combat fuel poverty whilst also seeking to reduce the overall carbon footprint of the City, making it an attractive place to invest and live.

4. The Outline Business Case

Outline Business Case Development

4.1 The Council has engaged with an Energy Consultancy over the last 10 weeks to evaluate the opportunity to establish a fully licensed energy supply company. It has also engaged with a leading Law firm in the energy sector to support the development of the Outline Business Case. A joint project team comprising officers of the Council and the Energy Consultancy has jointly prepared and built a business model and Outline Business Case that is capable of bringing to market a successful joint venture. The Outline Business Case is attached as confidential Appendix 1 and covers the following:

- Strategic Fit - Economic and Social Strategy (the alignment with national and local policy objectives);
- Energy Market - including policy and regulation, competition and analysis;
- The Business Model - including services provided, sales and marketing, energy sourcing strategy and tariff management;
- The Operational Strategy including organisational structure (including governance), regulatory compliance partners, IT strategy and implementation plan;
- Wider Energy Opportunities in the future, including scaling up activities locally and over a wider geography; and
- Financial & Commercial Assessment including the Base Case and key assumptions, scenario modelling, managing financial risk and the overall project delivery plan.

4.2 The Outline Business Case will be developed into a Final Business Case over the next 2 to 3 months and will include further analysis which will seek to ensure that the proposal itself and the method of delivery through the proposed Joint Venture arrangement as set out in the Outline Business Case achieves best value for money for the Council and that all appropriate options for delivery have been properly considered and evaluated. This Final Business Case will be the subject of an independent expert review by an independent consultant who will test the assumptions and financial projections set out in the Final Business Case.

Overall Aim and Objectives

4.3 The Council's overall aim is to deliver an energy strategy that seeks to achieve the following:

- Improve energy efficiency and enabling more affordable energy to residents as a mechanism to reduce fuel poverty and raise prosperity in the City more generally;

- Support carbon reduction and air quality improvement through the stimulation of investment into renewable energy sources and energy efficient installations;

- Enable provision of competitively priced energy to Business as a means to improve growth and productivity; and

- Provide an income stream to the City Council to re-invest in public services.

Rationale for the Joint Venture

4.4 The proposal is to set up a Joint Venture which subject to legal and accounting advice will most likely be a company limited by shares between PCC and an Energy Consultant. The Council brings ambition, financial resources, creditworthiness and marketing channels and the JV partner brings the industry knowledge, regulatory background, expertise, skilled resources and industry contacts.

Core Proposition

4.5 The core proposition and activities of the Energy Services Company (ESCo) joint venture (JV) shall be as follows:

- Supplying domestic energy to local consumers (this represents the core part of the business model);
- Improving the local community and environment through the direct investment of a proportion of surpluses from domestic energy tariffs;
- Supplying energy to Micro Businesses and other SME customers
- Commercial contracts to Industrial & Commercial (I&C) customers;
- Potential supply of energy to the Council's own Property and Housing portfolio (through a competitive process); and
- Providing energy expertise and advice for new innovations.

4.6 In relation to "Improving the local community and environment through the investment of surpluses" described above, this may take either or both of the following forms below:

(i) Direct investment by the ESCo JV expected to amount to £2.5m of investment funds (based on customer forecasts as set out in the Outline

Business Case) over 5 years to support local community and environmental initiatives; and /or

(ii) The Council's share of any profits distributed by ESCo JV to the Council will be used to protect and support the full range of Council Services which may otherwise have been exposed to service reductions.

4.7 To be of sufficient scale to operate viably, the ESCo JV will need to operate beyond the Portsmouth boundary. This will necessitate a suitable marketing and branding strategy that can appeal to customers across the region and be capable of being rolled out nationally in the future.

4.8 As part of the Business Case preparation, the Council has undertaken some market research on the core principles of the proposed ESCo JV. In summary terms, **80%** of domestic interviewees (500) and **88%** SME interviewees (50) would be interested in buying energy from a new local company backed and supported by the Local Council.

Deliverability

4.9 Critical to the deliverability of a successful venture is the strength of the Board and Senior Management. The proposed ESCo JV is proposed as a joint venture arrangement between PCC and a senior energy industry individual (“Key Individual") who currently operates an energy consultancy. The ESCo JV may be formulated with the Key Individual or the consultancy owned by the Key Individual, and PCC shall ensure the availability of the services of the Key Individual (on an exclusive basis) to the ESCo JV as a condition of the JV.

4.10 Throughout the pre-live stage, the proposed joint venture partner will be supported by two consultants, who, on launch, are expected to transition to Non-Executive Director positions. Both the joint venture partner and the two consultants own and operate their own independent energy consultancies with clients and contacts across the market.

4.11 It is proposed that the Key Individual will also act as the CEO of the ESCO JV as he has over 25 years of experience in the Energy industry through employment with one of the Big 6 energy suppliers, a career which has for the majority been at a senior leadership level.

4.12 The role of the two consultants will initially be to support the CEO in establishing the business, ensuring that key market risks are adequately addressed in the pre-live phase. Once the permanent leadership team are established, and on launch of the business, the roles are intended to transition into Non-Executive Director (NED) posts. In addition to providing support for forward business strategy, risk management and performance, the individuals will take on mentoring and coaching roles to support the developing management team. It is not proposed that these consultants will have any shareholding in the ESCo JV.

4.13 One of the consultants has over 20 years of experience in the Energy industry. In addition to twelve years' experience with one of the Big 6 energy suppliers, she has built, led and developed businesses across the market. The individual is a respected and regular speaker at industry and stakeholder events and brings a broad market perspective as well as specialist expertise in retail, flexibility and regulated markets. She is a member of National Grid's Power Responsive Steering Committee which is leading the development of flexible markets in the UK.

4.14 The second consultant brings 20 years of experience in the Energy industry with one of the Big 6 energy suppliers. He is a leading expert in the complex traded commodity markets and has held senior Director roles, leading trading and risk management functions. The individual is highly regarded for his expertise in the UK traded market and is in demand for these skills from a range of stakeholders.

4.15 The CEO and two consultants all bring a broad network of contacts from across the industry, including policy and regulation, investors, I&C consumers and technology, resource and professional service providers. This should "open doors" for energy supply, advisory and investment opportunities across both a local and broader geography.

4.16 The team, with PCC Officers, have developed the Business Case and the detailed project implementation plan for the proposed Joint Venture.

Governance

4.17 It is planned that the Board will comprise the JV partner plus non-executive Directors of strong industry reputation and appropriate knowledge, expertise and experience as well as PCC representation. The exact governance arrangements, shareholdings, rights to appoint and remove directors and voting rights will be determined once the Council has taken external legal advice from its appointed legal advisers. It is anticipated however that the form is likely to be a company limited by shares with the shareholding to be held by the Council and the proposed JV partner. This will be concluded in the 'pre-live' stage of the project but will be designated a key milestone for which a formal approval will be sought (under delegated authority).

4.18 Key principles of the Joint Venture structure will include the following:

- JV and associated Corporate Structures will be designed to conform with legal, regulatory, procurement and state aid requirements;
- It will be tax efficient;
- It will be established and operated as a commercial trading entity that will target a commercial return to the Council on its investment;
- It will reflect the relative financial risk and investment by each of the partners with equity shares to be determined on a pari passu basis which is expected to result in the Council taking a larger equity stake at inception;

- There will be provisions for equity shares to be re-balanced over time but dependent on the financial performance of the ESCo JV;
- There will be restrictions on the sale of equity shares to external parties with first call options for each of the JV Partners; and
- The structure will facilitate for a planned exit by the JV Partner and if required the Council in around 10 years either through a sale of the entire ESCo JV or for the Council to have pre-emption rights with respect to the purchase of the JV Partner's shares.

Financial Case - ESCo Joint Venture

4.19 The "Base Case" Financial Case has been formulated on a prudent basis, based on costs which can be evidenced, competitive tariffs and a customer uptake of 25,000 per annum with an allowance for customer turnover at the end of contracts. Whilst the base case is predicated on a customer uptake of 25,000 per annum, the target uptake will be to exceed this.

4.20 To provide assurance that the Business Case is robust, only the core proposition of an Energy Supply Company providing energy to domestic and non-domestic consumers has been modelled into the Base Case. It does not include many elements of the wider commercial strategy where additional margins can be made such as potential supply to the Council's operational estate, energy generation and energy advisory services.

4.21 The Base Case will require the Council to make an investment of £3.8m in accounting terms with an overall pre-tax surplus of £7.3m by year 5 and a pay back of the Council's investment in 3 years and 7 months. In cash flow support terms however, the funding requirement is much higher at £7.8m, largely reflecting the fact that cash is paid out for energy before the income from customers is received (i.e. credit risk). Whilst credit risk exists, the ESCo JV would expect to recover that outstanding income.

4.22 A sensitivity analysis has been undertaken to understand a range of possible alternative financial scenarios. The more optimistic (target) scenario is based on a customer uptake of 31,250 per annum. The overall investment required by the Council reduces to £3.5m generating an overall pre tax surplus of £13.7m by year 5 and a pay back of the Council's investment in 2 years and 8 months. The target uptake of 31,250 per annum could be achieved either by a very successful sales and marketing strategy, by widening the customer base beyond Portsmouth and its nearest neighbours and/or by extending the range of activities undertaken in the first 2 years of operation.

4.23 The most pessimistic scenarios include a reduced customer uptake by 25% per annum and a scenario that models a poorly executed energy sourcing strategy. Whilst neither scenario produces an overall positive return (in net present value terms[2]) over a 5 year period, by year 5 both of these pessimistic scenarios are generating an annual surplus and would have paid back the original investment (in cash terms) and deliver positive net present values by the end of year 7.

4.24 The financial business case "Base Case" is considered to be robust and prudent. As part of the Final Business Case an independent consultant will test the assumptions and financial projections set out in the Final Business Case.

Financial Case - Portsmouth City Council

4.25 The overall Financial Case for Portsmouth City Council is wider than the financial returns of the ESCo JV alone and is summarised below:

(i) Revenue Returns:

- The Council's share of the ESCo JV's anticipated annual dividend distribution (i.e. the post-tax return less amounts retained in the business for future investment / balance sheet resilience) as described previously and expected to be the majority share at inception;

- The additional energy management activities (net of referral fees to the ESCo JV) that will be routed to PCC's in house Energy Management Services arising from leads developed by the ESCo JV which will accrue directly to PCC estimated at £2.4m over the 5 year period;

- Receipt of net interest arising from providing a loan and/or credit facility on commercial terms for the ESCo JV in the early years of operation; and

- The future reduction in costs of energy for PCC's property estate arising from a competitive process for a supplier (potentially the ESCo JV) once existing energy contracts have expired.

(ii) Capital Returns (unrealised):

- The Council's share of the overall investment value of the Energy Partnership (i.e. its capital gain);

4.26 In overall financial terms, the level of financial risk is affordable to the Council, nevertheless in the event of a failure, there will be an opportunity cost of the use to which any funding that had been directed towards this investment that had not been returned.

[2] Net present value is a measure of monetary value in today's terms. It takes account of the "time value of money", essentially a method that provides a like for like comparison of options with different cash flows in different periods. The method recognises that a more favourable cash flow position of one option over another has a value in that that difference in cash flow can be invested and make a return (or avoids a borrowing cost). Alternatively explained as £1 today is more valuable than £1 in a year's time as todays £1 can be invested to earn interest.

Wider Economic & Social Benefits

4.27 Of critical importance are the wider benefits of the ESCo JV which can support the delivery of the Council's Energy Strategy objectives. These benefits include:

- The estimated £0.5million per year (£2.5m over five years) reinvested in local community and environmental initiatives aiming to improve the Carbon footprint;
- Competitive pricing to residents to help reduce fuel poverty;
- Competitive pricing for businesses as a means to improve growth and productivity;
- Supporting businesses to reduce consumption and generate their own electricity in order to provide for greater energy security and the carbon footprint and reduce costs;
- Actively seeking to stimulate inward investment in local renewable generated power to improve the carbon footprint and energy security; and
- Attracting inward investment by improving both the environment of the City and the cost of energy to businesses.

4.28 Assist in reducing Fuel Poverty - 11.8% of all Portsmouth households are in fuel poverty with the problem rising steadily with the increasing cost of energy. The most sustainable way of treating fuel poverty in the long term is by insulating homes and installing efficient heating systems. Alongside more competitive tariffs, the provision of reinvested funds from the ESCo JV will help to unlock funding for those most in need by providing a consistent level of support to be used in fuel poverty mitigation programmes.

4.29 Renewable Energy - There is significant opportunity to support direct or inward investment in new generation coming into the area, whether solar, wind or other technologies. With the combination of skill sets and industry and investor connections brought by the JV partner, coupled with PCC's commercial outlook and experience, there will be opportunities to make the area a focus of investment in new renewable technologies. Whilst being attractive to energy investors the overall impact of the result of the investment will be significantly wider. Having a SMART, clean and healthy City which is actively promoted as such, should attract broader inward investment and improve the social wellbeing of residents and businesses alike.

4.30 Future Investment - The ESCo JV has the potential to position PCC as a national leader of a new municipal energy market model providing a fully licensed energy company with industry expertise to manage and deliver energy initiatives and attracting additional funding for the area.

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Timescales

4.31 The process to form the ESCO JV and obtain the required licences to enable it to function as a licensed supplier are complex and there are a number of regulatory hurdles and requirements to meet. Implementation will therefore be delivered through a phased approach, the commencement of which can start as soon as the Outline Business Plan is approved. There are three broad phases as follows:

(i) Pre Live (to include preparation of the Full Business Case) - August 2017 to January 2018;
(ii) Smart Energy Code (SEC) accession and Controlled Market Entry (CME) - November 2017 to June 2018; and
(iii) Launch - July 2018 (this will be subject to all regulatory and licence requirements having been satisfied).

Pre-live - August 2017 to January 2018

4.32 Pre live activity will include the following:

- Conclude Final Business Case, including options appraisal to demonstrate value for money and independent expert review of the Final Business Case;
- Determine Corporate Structures and terms with the Joint Venture partner;
- Design and define the brand;
- Design and define core propositions with associated marketing material;
- Design and define end to end customer experience;
- Implement and test end-to-end system functionality;
- Design and define key business policies and controls, including risk management, cash management, delegated financial authorities;
- Complete procurement process for key systems and metering partners;
- Complete procurement process for energy trading partner;
- Define energy trading strategy;
- Recruit staff for launch;
- Establish office for launch;
- Develop marketing plan for launch; and
- Completing pre-readiness requirements for Controlled Market Entry and SEC User Acceptance.

Smart Energy Code accession and Controlled Market Entry - November 2017 to June 2018

4.33 Controlled Market Entry (CME) is a regulated process which needs to be completed and signed off prior to full launch. The business has to satisfy the regulator (OFGEM), through its partners, that it is ready to operate in the energy market, and most importantly is set up to interact with the industry codes and processes.

4.34 In addition to CME, under the Smart Energy Code recently introduced, all suppliers are now required to qualify as DCC users. This is a new requirement following the creation of the Data Communications Company (DCC) as part of the national roll out of smart meters. Existing suppliers are currently undergoing the process to become registered DCC users, and all are required to be complete by 25 November 2017.

4.35 The industry defined qualification process is estimated to take between six and eight months to complete. There are clearly defined requirements to meet, focused on testing the ability to meet the security and system interface requirements relating to smart meter operations.

4.36 For new entrants, the requirement is to complete the Smart Energy Code qualification prior to entering the Controlled Market Entry. Whilst every effort will be made to expedite the process to enable an earlier launch date, the plan is built on standard timelines provided in industry guidance

Launch - July 2018

4.37 The initial launch of the business will be focused on five key priority areas:

- Building brand awareness;
- Domestic sales of electricity, gas and energy efficiency;
- SME sales of electricity, gas and energy efficiency;
- Delivering excellent customer service; and
- Sourcing locally generated power.

Key Risks & Mitigation

(i) Regulatory Compliance

The rules that licenced suppliers are obliged to comply with are set out in the Standard Conditions of Electricity Supply Licence and Standard Conditions of Gas Supply Licence. Sitting underneath the licence conditions there are multiple codes governing market operations, all of which form a subset of the standard conditions. The codes are subject to regular modifications, proposed by market participants and approved ultimately by OFGEM. Suppliers are expected to remain compliant with what are continually moving goalposts. OFGEM has the power to issue an enforcement notice or fine a supplier up to 10% of their annual revenue for non-compliance.

Whilst this portrays an intimidating landscape, the reality in practice is significantly more benign. Since 2009, OFGEM have opened only 68 investigations many of which have resulted in enforcement notices or relatively small scale fines. The majority of cases have related to the Big 6.

Regulatory risk should in the first instance be mitigated through the regulatory process of successful progressing through CME; a regulated process that satisfies the Regulator that the ESCo is ready to operate in the energy market set up to interact with the industry codes and processes. In the main, OFGEM are supportive of suppliers, particularly new entrants and work with them to ensure that there are open communication channels and support for rectification of small scale licence breaches.

Ultimate responsibility for regulatory risk rests with the Board and Senior Management. A Risk Management Committee (RMC) will be constituted and be a sub-committee of the Board with delegated authority to manage the key business risks. Membership is likely to include the CEO, Director of Finance, Risk & Compliance and Director of Operations plus the Regulation manager as a minimum.

The day to day arrangements for compliance will be managed by a suitably experienced Regulation Manager that will both monitor market change, but also ensure that communication channels with OFGEM are open. Additionally, both the software and service of a contracted partner and Energy consultancy will also provide some mitigation to regulatory risk.

(ii) Wholesale Energy Risk - price and volume

The biggest risk associated with an energy supply company is ensuring that the right amount of energy is bought or sold to meet net demand. Energy can be bought up to around two years ahead of delivery, and also nearer term through day ahead and spot markets.

The fundamental approach to managing wholesale risk taken by all suppliers is to hedge the risk i.e. ensuring that energy has been bought for forecast demand ahead of time. Managing the combination of price and volume risk is a highly skilled activity and critical to the success of the business. The Outline Business Case describes how that will be managed through skilled and experienced individuals with responsibility for managing the risk and the energy sourcing strategy that will be adopted. The sensitivity analysis described previously also illustrates the impact of a poorly executed energy sourcing strategy which has the effect of lengthening the investment payback period for the Council.

(iii) Customer Uptake - 25,000 per annum

The Business Case (Base case) is predicated on a customer uptake of 25,000 domestic customers per annum.

A strong sales and marketing strategy is set out in the Outline Business Case to drive customer uptake. The sales and marketing strategy has its foundations based in the experience of other successful new launch strategies but with additional local features. Aside from the mainstream strategy, circa 1,200 customers are likely to be acquired as the ESCo JV is proposed to become the default supplier to Council (housing) properties. This arises from the number of social housing tenants that change tenancy each year which offers an ideal time to switch residents, which offers benefits to the Energy Partnership, the Council and the new tenant.

Whilst customer uptake of 25,000 per annum is considered realistic, the number of customers required for the ESCo to break-even is significantly lower.

(iv) Delay - Smart Energy Code accession and Controlled Market Entry

The most uncertain timing factors within the Business Case are the timescales for Smart Energy Code accession and (CME). Whilst both processes could be concluded early in 2017, the Business Case envisages a launch in July 2018. This assumes that Smart Code accession takes six months and runs in series with Controlled Market Entry which takes three months which is in line with guidance taken from OFGEM and associated bodies.

5. Final Business Case

<u>Gateways and Milestones</u>

5.1 The Outline Business Case has been prepared to assess the overall concept, operating model and financial model and test whether or not the establishment of the ESCo JV is viable in commercial terms, delivers the Council's objectives and capable of being delivered within the Council's risk appetite.

5.2 The Outline Business is considered sufficiently comprehensive to take an in principle decision to progress through to launch. A final decision however, will not be made until such time as the Final Business Case is complete and has been the subject of an independent expert review. The Final Business Case will involve further consideration of the following:

- The Council's powers to form, participate, invest and as required support the ESCo JV financially through provision of loans, working capital and guarantees in respect of energy trades and forward purchases;
- Procurement compliance;
- State Aid compliance;
- The terms of the JV arrangement and ensuring that investment arrangements are on a pari passu basis;
- Board membership and governance arrangements (including the rights to appoint and remove directors);
- Remuneration and terms of appointment of directors;
- Arrangements between PCC and the ESCo JV;

- Any necessary refinement of the financial model and associated sensitivity analysis;
- Contracting arrangements with third parties (including procurement of IT Services Provider);
- Compliance with the Council's Contract and Financial Standing Orders; and
- The proposed mechanism for the JV Partner and if required the Council to exit the ESCo JV.

5.3 A Governance Board will guide progress through to Final Business Case and remain in place until such time as the ESCo JV is established and its Board structure is fully functioning. The Governance Board will be chaired by the Leader of the Council and comprise the Director of Finance & S151 Officer, the Joint Venture Partner, an Energy Consultant and the City Solicitor or his representative and will authorise every key decision where financial risk and reputational risk is significant and will meet as necessary.

5.4 Key decisions (gateways and milestones) for the ESCo JV project will include the following:

- Approval of Final Business Case and the elements contained therein (as described above);
- Approval of the incorporation of the ESCo JV;
- Appointment of Senior Management Team;
- Appointment of Board Members
- Application for energy supply licences;
- Engagement with Ofgem and other industry bodies;
- Procurement of IT Services provider;
- Procurement of a fully functioning CRM system and complaints handling centre
- Billing and Metering contracts (MAM, MAP and MOP etc.);
- Any other requirement anticipated under the BSC/MRA entry process;
- Accede to the Data Communications Company (DCC)
- Accede to the Competent Independent Organisation (CIO) requirements; and
- Progression to Controlled Market Entry.

6. Conclusions

6.1 The establishment of a fully licensed ESCo JV with the core proposition of providing energy to domestic and non-domestic customers and undertaking other activities relating to energy management, renewable energy generation and advisory services is strategically aligned to both national and local policy.

6.2 The base case in the Outline Business Case ("Base Case") has been built on a prudent set of clear, supportable assumptions based on today's market. It is commercially viable as a domestic and non-domestic supply company alone and provides a solid return on investment for the Council. There are risks associated with the proposal which are inherent within any regulated market but such risks are mitigated through a strong Board and Management structure and outsourcing to competent and trusted third parties. The ESCo JV has many potential upsides or opportunities, many of which are only capable of being leveraged by having a full energy supply licence.

6.3 The wider social and economic benefits of the ESCo JV support the drive to reduce fuel poverty, reduce the carbon footprint, increase air quality and make the City an attractive place to invest.

6.4 The proposed timing for launch is appropriate, as the energy market is undergoing fundamental transformation with a clear direction of travel towards a more localised, distributed generation model. The Council is well placed to take advantage of the market opportunity and establish itself as a leader in creating a new municipal energy market model which more established national players will find difficult to replicate and compete with. Much of the market opportunity will emerge over the next five years, but by setting the business up for the future, the City Council has the potential to be a market leader.

6.5 This report provides the Outline Business Case for the establishment of a ESCo JV in principle. The actual establishment of the ESCo JV will be subject to the approval of a Final Business Case which will be subject to scrutiny and review by an independent expert consultancy.

7. Equality impact assessment

7.1 A preliminary EIA was considered but after proceeding through the process it was assessed that an EIA would not be required in this instance. This proposal relates to a commercial enterprise which will operate externally to the Council and will not impact the equality groups. The decision whether to proceed with the provision of supply to business or retail customers would be based purely on predetermined commercial decisions and would not impact negatively on residents or customers of various protected characteristics across the city.

8. Legal implications

8.1 The Council has the power to enter into the proposed ESCo JV pursuant to the general power of competence under Section 1 of the Localism Act 2011. In exercising this power the Council is still subject to its general duties, such as its fiduciary duty, and must exercise the power for a proper purpose.

8.2 Under Sections 1 and 12 of the Local Government Act 2003 the Council may borrow or invest for any purpose relevant to its functions or for the prudent management of its financial affairs. It is proposed that any lending to the ESCo JV will be structured on market terms and rates and so would not constitute State Aid.

8.3 The interface between the Council as a shareholder, consumer, and a generation asset owner, and the ESCo JV, as a separate legal entity fully licensed to trade in the electricity market, will need to be carefully considered at the point of each interface to ensure compliance with the statutory regime governing the electricity and gas markets ("Sectoral Regulations") and public procurement and state aid requirements.

9. Director of Finance's comments

9.1 The financial implications associated with the recommendations are contained within the body of the report.

………………………………………………
Signed by:

Chris Ward
Director of Finance & Information Services (S151 Officer)

Appendices:

Exempt Appendix 1 - Outline Business Case

Background list of documents: Section 100D of the Local Government Act 1972

The following documents disclose facts or matters, which have been relied upon to a material extent by the author in preparing this report:

Title of document	Location
Energy Partnership: Business Case to support the launch of a Joint Venture Energy Company- 29/06/2017	
MASTER EnergySupplyCo Feasibility Model - PortsmouthCC- v2017-05-15v0.1 060617	

The recommendation(s) set out above were approved/ approved as amended/ deferred/

rejected by ……………………………… on ………………………………

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Signed by:

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