CABINET DECISION 10TH AUGUST 2018 CALL-IN

Date 20 August 2018

Re: Victory Energy Supply Limited. Expert Review of Business Case. At the Cabinet Decision Meeting on 10 August. The Cabinet made the following decisions:

DECISIONS:

The Cabinet considered the options set out in the report, taking account of the potential risks and rewards, and determined that:

(1) Option 4 should proceed, i.e. to seek to enter into a "White Label" agreement with an existing fully licensed energy supplier;
(2) external support be sought to enable the Council to cease its investment in Victory Energy Supply Limited (VESL) at the lowest overall cost;
(3) any solar PV contracts entered into by VESL continue to be honoured by the Council;
(4) the Council develops a comprehensive campaign for tackling fuel poverty and looks to resume the promotion of PCC's energy saving website;
(5) an Outline Business Case be brought forward by the Council's in-house Energy Savings Team to re-evaluate commercial opportunities (previously approved by Cabinet 8 December 2016)

WE THE UNDERSIGNED MEMBERS OF PORTSMOUTH CITY COUNCIL WISH TO CALL-IN THE FOLLOWING DECISION ON GROUNDS 15.1 OF THE PORTSMOUTH CITY COUNCIL CALL-IN PROCEDURES, NAMELY WE:

<u>Believe the decision may be based on inaccurate, incomplete or incorrect information as evidenced below:</u>

- Customer Acquisition Statements made by the Leader of the Council around 26 mins into the meeting that:

  'PWC said 50k is far too many (customers) and should be reduced by half, back down to 25k.'

  This is a false statement, PWC did not say this. It is a clear misrepresentation of the independent experts report and demonstrates a failure to understand the key points. Para 6.2i of the main report states:

  "Revising year 1 total customer acquisition assumptions down by 50% - pushing year 1 growth targets back to month 18 by reducing the sales conversion rate to 2.5

sales per agent per day and uplifting the required number of sales agents accordingly, to enable year 5 target customer numbers to be achieved. This is reflective of a revised sales and marketing plan driven by door to door cold call sales and assumes that VESL's total cost base changes in responses to changes in the configuration of its sales teams.

In this statement PWC acknowledge their downside scenario reduces the customer numbers per agent per day, it models in a higher cost of employing more agents to compensate this in order to achieve the desired business case numbers by the end of year 5, and that this is achievable. So, the Leader basing this point as a reason not to invest in the company because PWC say 50k customers is too many is incorrect. This point is also reflected on pg 52 of the report.

- Marketing Approach. Around 28 mins the Leader of the Council says:
  'PWC and VESL have described this sales technique (door to door selling) as untried and untested'

  It is tried, tested and proved (PWC confirm this in their report), the approach is new but achievable. PWC conclude that *'switching is still at an all time high'*, **which will assist VESL. In the VESL presentation all members were made aware of a diagram which explained all the options open to VESL for marketing to attract customers. VESL can use any one of 11 features quoted at any time. PWC concluded under 6.1 of the report (bullet point 8 in the box) that:**

  Delivering the required level of acquisitions may require VESL to adapt its sales and marketing plan and use more proven sales channels. VESL should be well positioned to adapt quickly to a new approach, however, this may result in VESL's acquisition costs increasing and put downward pressure on margins.

- Investment Exposure Leader of the council states at 32 mins,
  'There's a possibility of a profit of £1.5m - £6m in year 5 or 6, and I think Chris you put it even later. The amount of money the council will have to lend VESL is £15m.'
  This is incorrect. The Leader of the council has clearly misunderstood the key risk exposure. In the Section 151 officer's report it states on page 5 what the peak financial exposure for the council is forecast to be in year 2 which amounts to £6.5million. Beyond year 4, the company would start to return annual profits and by year 10 have achieved significant financial returns. In 1.13 of the report it states:
  Taking the downside scenario of PWC and their advice to consider investment over 10 years (after repayment of the necessary up-front investment) would return circa £50million, representing both earnings of circa £27milllion and a customer book value of circa £18million.

This statement from the report encapsulates the total financial risk to the council in PWC's downside scenario. It is based on 10 years VESL accumulative earnings of £21m, other income stream to PCC which only come from VESL being in existence of £11.1m (interest charged on the loan, the community investment fund and the lead generation that VESL pass over to the PCC in-house team). This is not specifically covered in the VESL business case, but it is a total return to the investors (Council). This was made clear during the all-member briefings we received. It is important to note that £18.1 million is based on the PWC downside scenario. When all income to the council is added together it totals £50million.
The Leader of the council has demonstrated once again his error of understanding, judgment and interpretation of the independent advice, the section 151 officers report. The total return to the council is the basis upon which this decision should have been taken over a 10 year period.

- Risk exposure
  The recommendation of the report was not to agree at Cabinet to invest £12m or £19m based on the downside scenario, but to proceed with option 3 in the section 151 officers report (1.3 of the report) which recommended an annual review of the investment referred to by PWC as a 'stage gate governance process'. Said at 1.3. Comments that the cabinet made around risk are based on VESL business case only and not on all of information put before them in the report and highlighted by the Section 151 officer in his report. They failed to consider the other income streams that would be due to the council and also the company value which would be based on the customer book (above).

- The Leader of the council stated (at 35 mins) the 4 success factors as per the Section 151 officers report, he stated:
  "1. Governance – no public governance and therefore I have no confidence, 2. Business Plan which gives me no confidence in the VESL leadership team and they've not addressed the price cap. 3. Risk Management, I don't see a robust risk management (and therefore) no confidence. I have not been able to be persuaded that there are any of those four things in place."

  In response to this and specifically addressing these points the Section 151 officer said:
  "My advice is exactly if those things do not exist (the four criteria laid out in the PWC report) then you shouldn't proceed with the venture. <u>My comment on that was the independent expert reviews that have been undertaken **all** have a consensus that those things are in place.</u>

  It was the Leader who commissioned PWC and yet he has consistently failed to interpret the risk and comments reflected by PWC and Baringa the leading experts. Consequently, the Leader's comments influenced the rest of the cabinet, as he was in an informed position. Where is the leaders evidence for his comments above? The Section 151 officer said the

opposite and repeated the comments contained in his report in the meeting.

The Section 151 officer's reports included direct quotes from the independent experts such as

Senior Management Team. – 1.2 of the report "One of the key drivers for success in the GB energy supply market is the ability to find skilled and experienced individuals to lead and manage these businesses and navigate he various complexities. Both the key individuals bring an overall understanding of the commercial and operational fundamentals of the energy supply market. Jo Butlin in particular brings experience of running a non-domestic energy supply business and experience of advising other new entrants in the market" – (Baringa November 2017).

Agile business plan – 1.21 of the report "In our view, based on the following information provided, there is a reasonable expectation that the proposed business would generate returns to PCC that would be attractive to private investors, and it therefore sets out a good case for investment by PCC". (Baringa November 2017).

Robust risk management – 1.22 of the report "VESL has installed an experienced management team bad we understand the robust procedures that are putting in place should act as a source of risk mitigation for VESL" (PWC July 2018).

The opinion of the independent experts is clear and strong. The question is where is the contrary evidence that the Leader was relying on to base his comments and decisions?

- **Jeanette Smith said at 41.40 mins:**

  "Too much of a risk with public money and I would want that money spent more wisely in services we already have to debt advisors, housing you could use the money to build more homes to cut fuel poverty and to me that is what we are here for."

  This demonstrates a clear and fundamental misunderstanding of how to manage public finances. In fact, the inference, to spend borrowed money on revenue spend (debt advisors) and build houses is in fact illegal. Under the Local Government 1972 and the Rules in Public Life (Public Finances) no council is allowed to borrow money such as the £6.5million referred to in this report. Therefore, this comment does not support a constitutional basis for the reason for refusal from Cllr Smith.

- **Darren Saunders said at 50.28 mins**

  "We have been told the council has set aside £5.6million this year for Victory Energy. We must deal with fuel poverty, we must maximise income for when we need it not for when we don't…..There is a better less risky way that we can do that whilst offering a good deal for vulnerable people.

Darren Saunders at 46.20mins stated:
"Based on what I know about the tariffs behind those changes and what I understand about Victory's tariffs if we handed those properties to Victory when they contact comes up in September 2020 their bills would go up and not down."

Under 1.1 of the officers report the opening paragraph makes clear the key principle of the company ' to had the added objectives of reducing the fuel poverty for residents, reducing carbon impact and providing competitively priced energy to business'.

There are no tariff prices set for VESL at this time, so this is an unfounded statement.

- **Cllr Winnington stated at 53.45 mins**
  "We have to think about who is going to be targeted. We have been told very specifically told that this will be targeted at people who don't switch…..But who are these people? Generally, they are either older people which makes them more likely to be vulnerable or it is often people who are low income, have mental health issues for which changing energy suppliers is not high up on their list of doing things. So, if those are the type of people who are going to be targeted, that gives me some real real concerns"

  Page 6 of the report makes clear this about offering lower energy costs. Did Cllr Winngiton read the first Parra 1.1 of the report which specially mentions the core principles of the company being to address fuel poverty. 1.2 of the property also states clearly the added benefits of the company in assisting people to reduce consumption in.

- **Cllr Winnington said at 56mins:**
  " If a single person in this city pays a higher energy bill then they have to because they have been specifically targeted by this council's energy business then we have failed as a council and an administration"

  80 % of customers purchase their energy through the big 6 energy companies in the UK and in section 4.2 of the report the energy market characteristics are made clear. It was always the companies aim to be below the big 6 in terms energy tariff pricing. This comment from Cllr Winnington demonstrates is lack or understanding and therefore the wrong risk apportioned to his decision.

- **Energy Price caps have been mentioned through the meeting and superficially that VESL haven't included it in their RBC, but PWC have already factored it in to their report. The revised business case customer numbers On**

Pg 53 of the report, PWC confirm that it is plausible not to include the price cap effect, and there are mitigating factors..

- Before making a decision, the Cabinet should have investigated and explained the impact on Portsmouth City Council 's future budgets including anticipated income, expenditure and capital investments

SIGNED ON ATTACHED SHEET

By Councillors Donna Jones, Simon Bosher, Luke Stubbs, Judith Smyth and George Fielding