

Public Energy Company Outline Business Case

November 2021



Grant Thornton

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Dear Sirs

Public Energy Company Outline Business Case for Scottish Government

We have pleasure in enclosing a copy of our report in response to your Call Off instructions Contract reference CASE/429725 dated 31 January 2019. This document (“the Report”) has been prepared by Grant Thornton UK LLP (“Grant Thornton”) for the purpose of providing the Public Energy Company Outline Business Case (“the Project”) to the Scottish Government (“the Addressee”). The Report sets out the findings of our work undertaken in the form of the desired Outline Business Case.

We agree that an Addressee may disclose our Report to its professional advisers directly involved in the Project, and also to officers and members of Scottish Government solely in relation to the Project or as required by law or regulation, the rules or order of a stock exchange, court or supervisory, regulatory, governmental or judicial authority without our prior written consent but in each case strictly on the basis that prior to disclosure you inform such parties that (i) disclosure by them is not permitted without our prior written consent, and (ii) we accept no duty of care nor assume responsibility to any to any person other than the Addressees.

Whilst prepared by Grant Thornton, this report reflects the views of Scottish Government, including its other advisers, it does not purport to represent the sole views of Grant Thornton.

The Report should not be used, reproduced or circulated for any other purpose, in whole or in part, without our prior written consent, such consent will only be given after full consideration of the circumstances at the time. These requirements do not

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To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than Scottish Government for our work, our Report and other communications, or for any opinions, we have formed. We do not accept any responsibility for any loss or damages arising out of the use of the report by the Addressee(s) for any purpose other than in connection with the Project.

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Scope of work and limitations

The scope of our work has been limited both in terms of the areas which the analysis considers and the level of detail into which the analysis goes. There may be matters, other than those noted in this Report, which might be relevant in the context of the Public Energy Company, which a wider scope review might uncover.

The extent of our duty for the work to the Addressees and our liability for the work is as set out in the terms of agreement reference CASE/429725 dated 31 January 2019 between Scottish Government and Bramble and the underlying Management Consultancy Services Framework (Agreement Ref RM 3745) dated 21st August 2017.

Forms of report

For your convenience, the Report may have been made available to you in electronic as well as hard copy format, multiple copies and versions of the Report may therefore exist in different media and in the case of any discrepancy the final signed hard copy should be regarded as definitive.

General

The Report is issued on the understanding that Scottish Government has drawn our attention to all matters, financial or otherwise, of which they are aware which may have an impact on our Report. Events and circumstances occurring after the date of our Report will, in due course, render our Report out of date and, accordingly, we will not accept a duty of care nor assume a responsibility for decisions and actions which are based upon such an out of date Report. Additionally, we have no responsibility to update this Report for events and circumstances occurring after this date.

Notwithstanding the scope of this engagement, responsibility for management decisions will remain solely with Scottish Government and not Grant Thornton. Scottish Government should perform a credible review of the recommendations and options in order to determine which to implement following our advice.

Contacts

If there are any matters upon which you require clarification or further information, please contact Andy Boak on 0131 659 8522 or Neil Peckett on 0131 659 8540.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Andy Boak', is centered on the page. The signature is fluid and cursive.

Grant Thornton UK LLP

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1 Glossary

Item	Meaning	Description
Base Case		This is the preferred solution as identified in the Economic Case. The financials of the Base Case are explored in the Financial Case.
Capital Expenditure		Funds used by a company to acquire or upgrade physical assets such as land, buildings or equipment.
CBCS	Community Benefit Company or Society	
CLG	Company Limited by Guarantee	
CLS	Company Limited by Shares	
Commercial Case		The Commercial Case assesses the preferred delivery option, as identified by the Economic Case, and explores the potential corporate, legal and commercial structures available. It sets out the commercial options, funding approach and procurement strategies.
CIC	Community Interest Company	
Counterfactual		Assesses the financial benefit of the proposed Public Energy Company against a calculated 'Business as Usual' or 'Do Nothing' scenario
COSLA	Convention of Scottish Local Authorities	The national association of Scottish councils that acts as an employers' association for its 32 member authorities
ECO	The Energy Company Obligation scheme	A government energy efficiency scheme in Great Britain to help reduce carbon emissions and tackle fuel poverty.
Economic Case		The Economic Case appraises the options and determines the preferred

Item	Meaning	Description
		solution based on the appraisal criteria set out.
Financial Case		The Financial Case sets out to demonstrate the affordability and funding of the preferred option, it examines the benefits and costs of the Base Case preferred solution.
Financial Model		A mathematical model, typically an excel workbook, designed to represent a simplified version of the performance of the financial aspects of a project. The Financial Model is developed to include the commercial structure and financing solution.
FPS	Scottish Fuel Poverty Statement	
Fully Licensed		An energy supplier who is a fully licensed gas and electricity supply company, regulated by OFGEM. They must comply with all associated industry regulatory requirements.
HMT	Her Majesty's Treasury	
HMT Green Book	Her Majesty's Treasury Green Book	
IPS	Industrial and Provident Society	
Internal Rate of Return	IRR	Estimates the profitability of a project. It is the discount rate which makes the Net Present Value (NPV) of a project equal to zero.
LLP	Limited Liability Partnership	
Local Authorities		Refers to the 32 local authorities in Scotland.
Management Case		The Management Case sets of the project management, proposed timetable and governance arrangements from the OBC phase to

Item	Meaning	Description
		the establishment of the Public Energy Company.
Nominal Prices		The value of an item expressed in money terms at a specific point in time. This value therefore takes into account the impact of underlying inflation on the money value. This compares to Real Prices which removes the inflationary impact.
NPC	Net Present Cost	The total cost of a Project after taking into account the time value of money. In public sector investment appraisal, this would use the HMT discount rate (which starts at 3.5% for the first 30 years and then reduces from this point).
NPV	Net Present Value	The equivalent value of an investment today, taking into account cash flows and discount rates over the lifetime of the investment. In public sector investment appraisal this would use the HMT discount rate (which starts at 3.5% for the first 30 years and then reduces from this point).
OBC	Outline Business Case	An OBC sets out the preliminary analysis, findings and plans for a proposed project. It contains information used for decision making on the next steps of a project.
Opex	Operating Costs	On-going costs of running a business or system.
Payback Period		Amount of time taken for an investment to break even.
PPA	Power Purchase Agreements	A legal contract between an electricity generator and a power purchaser to buy/sell electricity at an agreed price.
Project		The proposed Public Energy Company to be established.
Project IRR		Project IRR represents the weighted average cost of capital for a Project. It is usually calculated from all of the non-financing Project cash flows,

Item	Meaning	Description
		including capital costs, operating and maintenance costs, revenues and working capital adjustments.
Real Prices		The Nominal Price adjusted to account for price inflation over time.
Risk Register		A risk register is a risk management tool in which the risks of the Project will be identified and allocated to Project team members for monitoring and management.
Sensitivity Testing/ Analysis		These are different scenarios run on a Financial Model to see what impact the scenario would have on the Project.
SOC	Strategic Outline Case	The purpose of a SOC is to present the case for change and assess the scope and feasibility of a project. A SOC was published in March 2018 for this Project so any references throughout are to this SOC.
SOLACE	The Society of Local Authority Chief Executives and Senior Managers	The members' network for local government and public sector professionals throughout the UK.
SMEs	Small and Medium-sized Enterprises	
SoLR	Supplier of Last Resort	An energy supplier who will step in to provide gas and electricity when a current supplier is no longer able to perform its function.
Strategic Case		The Strategic Case outlines the strategic justification for a project and the drivers for change.
SVT	Standard Variable Tariff	A standard variable tariff is a supply contract with an indefinite length that does not have a fixed-term applying to the terms and conditions.
VAT	Value-Added Tax	

Item	Meaning	Description
WHD	Warm Homes Discount scheme	Places a legal obligation on medium and larger energy suppliers to deliver support to people living in fuel poverty or a fuel poverty risk group.
White Label/White Label Agreement		Contracting with an existing, fully licensed energy supplier to provide Public Energy Company branded gas and electricity to customers. There would be formal documentation in place detailing the full terms of the White Label Agreement between the third-party energy supplier and the Public Energy Company.
White Label Supplier		In the OBC, any reference to 'White Label Supplier' refers to the third-party supply company which would be chosen to partner with the Public Energy Company to supply gas and electricity to the Public Energy Company's customers under a White Label Agreement.

2 Executive Summary

2.1 Purpose

This Outline Business Case (OBC) examines the potential delivery options for the establishment of a publicly owned energy company (Public Energy Company) and recommends a preferred delivery option, building on the work previously commissioned by Scottish Government in the development of a Strategic Outline Case (SOC).

In accordance with HM Treasury Green Book guidance, this OBC has been developed using the Five Case Model. The purpose of this Executive Summary is to summarise the findings under the five cases, namely the:

- Strategic Case;
- Economic Case;
- Commercial Case;
- Financial Case; and
- Management Case.

Throughout this OBC, reference is made to the actions that could be undertaken in the establishment and ownership of the Public Energy Company. It should be noted that, at this time, the final form and ownership structure of the Public Energy Company is yet to be determined – this will follow discussions with Local Authorities, which are ongoing. As such, where the document refers to actions the public energy company owners will take in respect of the Public Energy Company, this should be read as referring to the actions of the public sector investors working in collaboration to deliver a viable and successful Public Energy Company.

2.2 Strategic Case

This case provides the strategic justification for the Project, it outlines the background and objectives of the Project and assesses the stakeholder impact, key benefits and risks.

Background

The Scottish Government wish for a Public Energy Company to be established, with the principal aim in the first instance of helping to alleviate fuel poverty in the Scottish market. The Scottish Government issued a Draft Fuel Poverty Strategy in June 2018 which discusses how eradicating fuel poverty is crucial to achieving a fairer, socially just and sustainable Scotland. The strategy also outlines a number of actions to be taken which include establishing a Public Energy Company.

As explained further in the Strategic Case, 24.9%¹ of households in Scotland are classified as being in fuel poverty, therefore it is clear there is a need for work to be done to reduce this figure. On 10 October 2017 The First Minister announced the intention to set up a Public Energy Company before the end of the current parliament (March 2021). Following this, Scottish Government developed the SOC, which presented the case for change and explored the initial options as well as the feasibility of the Project. It concluded that it would be possible to establish a Public Energy Company which would be capable of delivering competitively priced energy to help alleviate fuel poverty in Scotland.

Project objectives

The key objective of the Public Energy Company is to reduce fuel poverty in Scotland which is both a short and a long-term goal. In order to do this the Public Energy Company aims to offer competitively priced energy and to encourage and increase consumer engagement with the market in order to encourage switching of suppliers by customers to obtain a better deal. There are also additional long-term objectives which the Public Energy Company seeks to achieve, including:

- Addressing climate breakdown and utilising renewable energy sources;
- Providing support to off-grid customers;
- Streamlining and consolidation of existing government energy policies; and
- Broadening of the Public Energy Company's initial target market.

Details of these, and other project objectives, are presented in the Strategic Case.

Key Stakeholders

The Project has a number of key stakeholders:

- Local Authorities in Scotland;
- Government;
- Fuel poverty organisations;
- Utility Companies; and
- Consumers.

It was and remains important that these stakeholders are involved and considered in the consultation and decision-making process. The Scottish Government has highlighted the importance of Local Authority engagement and involvement in the Public Energy Company and therefore their participation is crucial.

¹ [Scottish House Condition Survey Key Findings - Fuel Poverty](#)

2.3 Economic Case

The purpose of the Economic Case is to demonstrate the economic benefit of the preferred solution, determining which option to take forward into the commercial options appraisal (conducted in the Commercial Case). It presents the proposed delivery options for the Public Energy Company and the methodology behind the initial selection of these options. It then discusses the criteria against which each of the chosen delivery options have been assessed to reach a preferred option. This preferred option has then been subject to economic modelling and has been risk assessed.

The Economic Case outlines the following proposed delivery options:

- Option 1: Fully Licensed Supply – A Public Energy Company would be established as a licensed gas and electricity supplier with full responsibility for complying with all regulatory requirements.
- Option 2: White Label Supply – Contracting with an existing licensed energy supplier to provide Public Energy Company branded gas and electricity to customers. The chosen third-party supply company then pays fees to the Public Energy Company for each customer that switches. This generates income for the Public Energy Company.
- Option 3: Do Nothing – Continue with existing energy policies and do not establish a Public Energy Company in Scotland.

These options are an evolution of the options considered in the SOC. The purpose is explained in greater detail in section 3.4 of the Strategic Case.

The Economic Case scores these options against evaluation criteria to determine the preferred delivery option.

Each option was assessed on a yes/no basis against two mandatory criteria, to 'pass' required the option to be a yes to each of the criteria, a no to either criteria resulted in automatic exclusion as an option. The two mandatory criteria were;

- The chosen option must be capable of being fully implemented and be operational no later than March 2021 (in order to align with the First Minister's stated intention to establish the Public Energy Company by the end of the current parliament).
- The chosen option must be capable of being implemented without any breach of State Aid legislation.

Discretionary scoring was applied as a weighting to the importance of each criteria multiplied by the perceived ability of the option to deliver against this criterion. This resulted in each option receiving a score between 1 and 10, with 1 indicating a 'weak' performance and 10 a 'strong' performance. It should be highlighted that an option with a 'strong' performance score that 'failed' either of the two mandatory criteria resulted in automatic exclusion.

Based on the scoring of the options, White Label Supply was assessed as the preferred delivery option. While a Fully Licensed Supply option would have also received a competitive score, it was excluded as a result of the mandatory criteria,

as it has been assessed as not being deliverable within the required timeframe (by March 2021).

It was also noted that the Fully Licensed Supply option also carries with it significantly greater initial set-up costs and has a much higher working capital demand, as well as a significantly greater risk exposure. In addition to initial set-up costs estimated to range from £2.5m - £4m and a working capital requirement estimated to be in the region of £3.5m, there would also be a requirement for significant credit for balancing and settlement, network charges under industry codes with wholesale trading partners and under renewables schemes such as the Contracts for Difference, with a credit requirement of c.£7m expected during the winter months per 100,000 customers. Furthermore, it is noted that Fully Licensed Suppliers are often significantly loss making during their initial years of operation – for example Robin Hood Energy has been funded to a total of £25.5m by Nottingham City Council and Bristol Energy in the region of £36m by Bristol Council². This presents a significantly greater risk profile and level of exposure than that experienced under the White Label Supply option.

The preferred delivery option is therefore to establish a Public Energy Company under a White Label Supply arrangement with an existing fully licensed supplier operating in the market. A White Label Supply set up also puts a flexible vehicle in place which can demonstrate the success of the Public Energy Company and allows for development into a Fully Licensed Supplier in the future if desired. The table below demonstrates the outcome of the scoring – please refer to the Economic Case for the detailed scoring breakdown.

Table 1 - Summary of Economic Scoring

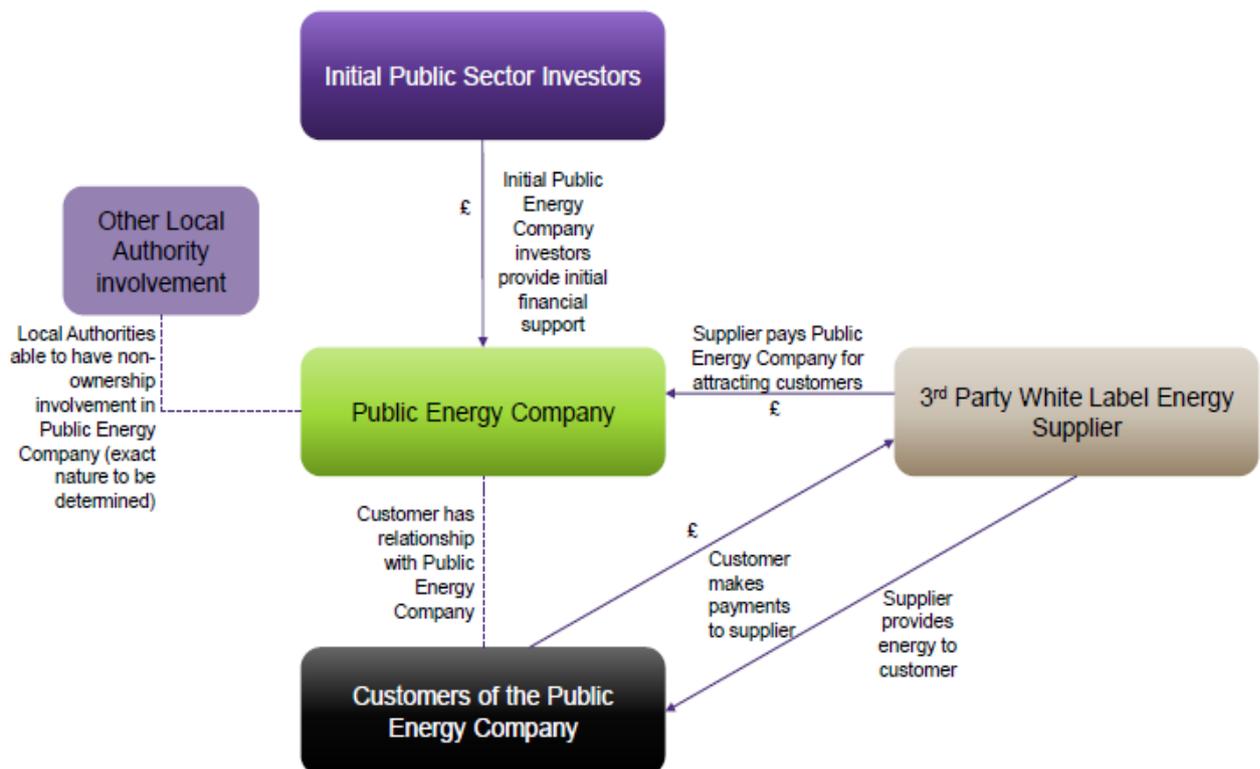
Detail	Fully Licensed Supply	White Label Supply	Do Nothing
Mandatory Pass/Fail: Can option be fully implemented and be operational no later than March 2021	No	Yes	Yes
Mandatory Pass/Fail: Can option be implemented in compliance with State aid legislation	Yes	Yes	Yes
Overall weighted score (out of 10)	N/A	6.83	1.59

² Source: Cornwall Insight

2.4 Commercial Case

The objective of the commercial options appraisal is to assess the preferred delivery option and the corporate, legal and commercial structure of the Public Energy Company by considering each options' benefits and associated risks. The proposed structure of the Public Energy Company is shown in the figure below. Owners of the Public Energy Company are represented at the top of the diagram. The proposed ownership structure allows for the exact split of ownership to be determined once more information on the various Local Authorities position in respect of the Public Energy Company is known. It should be noted that as the Project proceeds into the commercialisation and procurement phases, we recommend the below structure is reviewed in detail by legal advisors.

Figure 1 – Possible structure



Commercial Options Appraisal

The following commercial options were considered by the advisor team:

- Company limited by shares (CLS) – A private company limited by shares is an easily understood structure which is backed by the Companies Act. This structure limits liability of stakeholders and the limited company itself is liable to taxation. A CLS can trade, raise finance, invest in or be sold to third party investors;

- Company Limited by Guarantee (CLG) - Compared with a CLS, a CLG will not have any share capital and it will have members rather than shareholders, who contribute a nominal sum to the liabilities of the company which are repaid in the event of the CLG being wound up;
- Community Benefit Company or Society (CBCS) – Involves the provision of services through a ‘not for profit’ entity. The community benefit organisation may be a company limited by guarantee (CLG), Industrial and Provident Society (IPS) or a Community Interest Company (CIC). The entity conducts business for the benefit of the community, it may also be established as a charity if it has charitable objectives; and
- Limited Liability Partnership (LLP) – A limited liability partnership is a hybrid of a company and a partnership. It is a separate legal entity and LLP member’s liability is limited. The relationship between the members of an LLP is governed by private agreement. An LLP does not have shareholders or directors and is taxed like a partnership.

For the appraisal a number of considerations were outlined:

- Control and governance;
- Stakeholder management;
- Growth;
- Exit strategy;
- Self-financing;
- State aid compliant;
- Tax efficient;
- Future flexibility and strategic development
- Potential for charitable status; and
- Classification.

Funding

Per the evaluation undertaken in the economic case, a Public Energy Company established under a White Label approach with a licensed energy supplier has been selected as the preferred option. One of the key benefits of this approach is that the level of funding, both up-front and ongoing, and resource requirements needed to establish the Public Energy Company is significantly lower than would be required under other options, such as the establishment of a Fully Licensed energy company. In addition, the amount of work required to establish such an entity is also minimised. This is due to the significant capital and regulatory costs that are necessary to be incurred in the establishment of a fully licensed energy supply company, details of which are described in greater detail in section 4.2.1. In contrast, for a White Label arrangement the set-up costs are anticipated to be c.£250k. A full breakdown of this

figure can be found in Appendix D. The set-up costs include items such as legal support, tendering for a White Label partner supplier, marketing strategy and web design.

The proposed delivery option of a White Label agreement has no capital expenditure requirements (although there are still set-up costs and early year anticipated deficits as the company gets established). Consideration of the costs of the various options is included within the Economic Case. In addition, the third-party energy supplier selected to be the White Label Energy Supplier would be expected to provide many of the support functions required by the Public Energy Company, including customer service.

It is anticipated that there will be a mixture of interested public sector parties involved in the establishment of the Public Energy Company, with the level of Local Authority involvement to be determined through ongoing discussions with the Local Authority cohort. Therefore, the exact source of funding will depend on the appetite of individual Local Authorities to invest directly into the Project. There are 32 Local Authorities in Scotland who potentially may choose to participate and/or invest in the Public Energy Company.

Procurement strategy

Given the wider public interest element of the roll out of the Public Energy Company, the current working assumption is that a Restricted Procedure process is followed (a Competitive Dialogue process has been considered, which would allow for deeper engagement with the market, however, the cost implications of this and the timetable to required operational commencement mean this approach was not considered appropriate). Throughout the process, it is recommended that Scottish Government externally appoint Technical, Financial and Legal advisers to act in the best interest of the public sector and ensure that the procurement specifications are sufficiently detailed to achieve the desired outcomes. In order to maximise the recoverability of Project expenditure, it is anticipated that the Public Energy Company will be incorporated (assuming the ultimate form of the Public Energy Company requires it) and VAT registered in advance of the incurrence of costs relating to the establishment of the operation. The costs of procurement, as not reflecting the costs of the Public Energy Company itself, have been excluded from the assessed costs of the Public Energy Company. The extent of these costs, which will be incurred in bringing the Public Energy Company to market, will vary depending on the procurement approach adopted and the complexity of the desired solution.

Market interest and soft market testing

Initial soft marketing has been undertaken by Scottish Government, with the primary objective of obtaining feedback on the structuring of the commercial offering and levels of interest from potential third-party energy suppliers into any procurement process.

The following conclusions can be drawn from the market engagement undertaken:

- 1) While not all the parties approached expressed an interest in engaging with the subject of supporting the establishment of a Public Energy Company, there was sufficient interest across the space that suggests it is worth exploring further.
- 2) It should be noted that there are a number of different methods and approaches identified by which the market would like to engage with a Public Energy Company. Any procurement approach undertaken should seek to avoid being overly prescriptive. This will allow the market to present their own solutions for engaging with the Public Energy Company, thereby allowing potential innovative approaches to addressing fuel poverty.
- 3) There was no clear preference for a retention or an acquisition model – indeed a hybrid approach was also suggested as a possible solution. As such, the Public Energy Company should have a degree of flexibility in exploring the approach that it thinks will be most beneficial.

In summary, the early market engagement was received positively, and a plan for future engagement should be developed as part of the commercialisation process. Under the preferred delivery option, it will be necessary to secure a White Label supply agreement with an existing energy company to energy to the Public Energy Company's customers.

Conclusion

Based on the analysis undertaken, it would appear that either a charity (set up as a CLG or CBS) with a wholly owned subsidiary (potentially set up as a CLS), or a structure involving an LLP could provide an appropriate commercial structure which is tax efficient. However, we would highlight that a number of confirmations would be required in order to investigate whether this is appropriate. In particular:

- Legal advice should be sought to confirm that the vehicles outlined above are appropriate
- Further consideration needs to be given to the mechanism by which any surpluses are applied

As noted throughout the Commercial Case, the comments made in this Outline Business Case are for the purposes of informing a discussion on the possible structures that may be considered for the Public Energy Company. No action should be taken by Scottish Government without further discussion and obtaining detailed legal advice.

2.5 Financial Case

The Financial Case examines the benefits and costs of the preferred solution. The basis for considering these benefits used the following metrics, which result from the manner in which the Project is commercially structured and how it is funded. These include:

- Internal Rate of Return;
- Net Present Value; and
- the overall financial benefit of the Project.

The financial case presents two key options for the proposed White Label solution, the Acquisition Model and the Retention Model:

Table 2 – Core models

Retention Model	Acquisition Model
<p>The Retention Model assumes that, once a customer has switched to the Public Energy Company, that the White Label Supplier the Public Energy Company is partnered with pays a monthly retention fee for each month that the customer remains with the Public Energy Company. This is assumed to be £1 / meter / month (so the supply company pays the energy company £2 a month for a customer on a dual fuel tariff).</p>	<p>The Acquisition Model, in contrast, assumes a £25 upfront payment by the energy supplier to the Public Energy Company for each new customer meter that switches to the company. There are no follow-on payments from the energy supplier to the Public Energy Company – this approach therefore improves the upfront cash position but requires the consistent identification of new customers for the network.</p>

These two models are considered to be in line with current market White Label arrangements . The option which is projected to yield the best result is explored further in full in the Financial Case however it should also be noted that the final option will somewhat depend on the appetite and preferences of the White Label energy suppliers. In addition, as part of the scenario testing undertaken in the preparation of the Outline Business Case, we have prepared a ‘hybrid’ approach scenario, which allows for a blend of the retention and the acquisition model.

The Financial Case assumes that the procurement process starts between September 2019 – March 2021 with operation commencing in April 2021. The Financial Model covers a period of 10 years from the point of operation.

Modelled Scenarios

As outlined above, the Financial Model has been used to calculate core Retention and Acquisition Models for the preferred White Label option. A number of sensitivities have also been performed to assess the impact on both of these scenarios. These are shown in the table below. In addition to sensitivities we have modelled core, optimistic and pessimistic scenarios. The assumptions underpinning

these are detailed in the Financial Case. While only the Core scenario outputs are presented in this Executive Summary, the Financial Case provides the detailed outputs of each of these scenarios in turn and demonstrate both the potential upside and the potential downsides of the forecast returns, depending on the assumptions applied.

Table 3 - Project sensitivities

Scenario	Name	Details
1 / 2	Core Scenarios	<p>As noted in the Introduction, two 'Core' scenarios have been prepared – the Retention Model and the Acquisition Model</p> <ul style="list-style-type: none"> - The Retention Model assumes a monthly payment from the White Label energy supplier for each customer served by the Public Energy Company. The key assumptions supporting this scenario are documented throughout the Financial Case. - The Acquisition Model assumes a one-off payment from the White Label energy supplier for each customer that switches to the Public Energy Company. The key assumptions supporting this scenario are documented throughout the Financial Case.
Scenario variations		
3	Blended	<p>Under this scenario, a blending of the retention and acquisition model is presented, with income received from the energy supplier for each new customer meter joining the company received both an upfront one-off payment of £12.50 (in the same manner as the acquisition model), but also an ongoing retention payment of £0.50 per month (in the manner of the retention model)</p>
4 / 5	Optimistic	<p>The optimistic scenario uses a similar set off assumptions to the Core scenario, however assumptions regarding revenue levels and customer take-up are improved, and projections of cost are reduced (as detailed in the Financial Case), in order to show how the Public Energy Company could develop under favourable market conditions.</p>
6 / 7	Pessimistic	<p>The pessimistic scenario uses a similar set off assumptions to the Core scenario, however assumptions regarding revenue levels and customer take-up are reduced, and projections of cost are increased (as detailed in the Financial Case), in order to give an indication of how the</p>

		Public Energy Company may perform if projections are not as positive as those anticipated under the Core scenario.
Funding sensitivities		
8 / 9	Equity funding	The Core Scenarios assume that the working capital required to fund the development of the Project is made in the form of a revolving loan facility. Under these scenarios this is replaced with a contribution in the form of equity, repaid to the Investor at the end of the Project.
10 / 11	Grant for set-up costs	The Core Scenario assume that the working capital required to fund the development of the Project is made in the form of a 10-year annuity loan facility. Under these scenarios this remains true, however the set-up costs of c.£250k of establishing the company are provided in the form of a grant to the Public Energy Company to reduce the need for debt funding.
12 / 13	Increased interest charge	The Core Scenarios apply an interest rate to debt provided from investors at a rate of 5.09% (refer to Section 6.14 for details). Under these scenarios an interest rate of 11.09% is charged, should the Public Energy Company be identified as a 'high-risk' investment. Section 6.14 explains the reasoning for this.
Pricing sensitivity		
14 / 15 / 16 / 17	Revenues + / -	Under these scenarios, the revenue assumptions used in Optimistic and Pessimistic scenarios replace those used in the Core assumptions, to assess the impact of improved/worsened revenue negotiations, without the other variations seen in the Optimistic/Pessimistic Cases
18 / 19 / 20 / 21	Costs + / -	Under these scenarios, the cost assumptions used in Optimistic and Pessimistic scenarios replace those used in the Core assumptions, to assess the impact of improved/worsened costs, without the other variations seen in the Optimistic/Pessimistic Cases

Funding

One of the key benefits of White Labelling being the preferred option is the required level of funding is significantly lower than would be required under other options. There are no capital requirements under this option and the third-party supplier will carry many of the support function costs.

The core scenarios under the Financial Model assume that a Public Energy Company in the form of a limited liability company will be established, into which investors can make pinpoint equity investment in proportion to their ownership. However, it should be noted that this is an assumption made for modelling purposes and does not reflect an assertion that this presents the most appropriate commercial structure for the Public Energy Company.

Financial Results

The calculations performed in the Model demonstrate that there is an overall financial benefit for the domestic customers switching to the Public Energy Company, based on the tariff assumptions made. The values included in both the Public Energy Company scenarios and the Counterfactual scenario for the Preferred Option are based upon the commercial assumptions prepared by Cornwall Insight. Assumptions made are based on 'best estimates' available and knowledge of the market at the time of writing. It should be noted that these are high level assumptions and, as assumptions are projected into the future these become less and less certain.

Confirmation of the Preferred Delivery Option decision

The results of the two Core scenarios are as follows:

Table 4 – Returns of the Core scenarios

Scenario	Project IRR (pre-tax) %	Investor IRR %	Investor NPV £000s	Investor payback period (years) (nominal)	Investor net cash flow £000s	Initial Investment required £000s	Dividends paid by Public Energy Company £000s
Scenario 1 – Retention Model Core scenario	61.19 %	34.45 %	12,086	6	23,350	2,914	22,540
Scenario 2 – Acquisition Model Core scenario	141.75 %	62.73 %	3,251	3	5,680	297	5,597

It should be noted that the IRR figures for investors include the impact of the return on money lent to the Public Energy Company at a State aid compliant rate (assumed to be 5.09% - refer to Section 6.14 for more details), with the remainder being a reflection of the dividends the Public Energy Company is able to pay which, it is assumed, would be used to address fuel poverty issues in Scotland. The right-hand column in the table above shows the dividends forecast to be paid under each scenario over the ten-year operating period.

Under each of the Retention and the Acquisition Model, the initial investment requirement is set at a level that provides sufficient working capital to meet the set-up costs and working capital requirements of the company, such that there is no requirement to draw down on additional funding or seek alternative funds – e.g. overdraft facilities. As the Retention Model provides lower initial cash flows than the Acquisition Model (as it receives income over time rather than an up-front payment), there is a greater requirement for an initial loan, however the long-term benefits are significantly greater.

While the IRR presents as better under the Acquisition model, it should be noted that the Retention model shows much greater long term cash flows (based as it is on a recurring revenue stream – this is best demonstrated by the comparative NPVs of the two approaches, as well as indicated by the Net Cash Flow position).

In summary, based on the work undertaken in the Financial Case, the preferred financial solution for the Public Energy Company is:

- An energy company providing energy to market through a contractual arrangement with a White Label Supplier.
- 100% public sector owned, with the flexibility to allow public sector partners to have an appropriate level of involvement;
- Public sector funding is assumed to be provided in the form of a 10-year annuity loan facility. 100% of all funding requirements are provided from the public sector;
- The maximum debt required, based on the core assumptions, is incurred in the year to March 2021 – the table above shows the values required under each scenario;
- Public sector sponsors are currently determining their relative share of this investment;
- Surpluses generated will be paid out of the Public Energy Company and used to fund programmes designed to help reduce fuel poverty in Scotland; and
- The proposal has the flexibility to allow for either the Retention or the Acquisition model of generating revenues – or, indeed, a blend of the two – this will be refined through discussions with the market in the commercialisation phase of the Project. The positives and negatives of each are summarised in the Financial Case.

It should be noted that if, as discussed in the Commercial Case, for example, the Public Energy Company is able to set up with a charitable arrangements in place, it may be in a position to improve this position further through reducing/removing the requirement to pay corporation tax. Further input from your legal advisors will be required to determine the most appropriate commercial structure, which will impact upon the financial modelling.

2.6 Management Case

The purpose of the Management Case is to set out the Project Management and governance arrangements as the Project develops from the OBC phase to an established Public Energy Company.

The current stages of the Project are as follows:

Table 5 – Phases of Project

Outline Business Case	This is the current stage which sets out the Business Case for the Project and how it will be delivered.
Confirmation/revision of the preferred solution through continued engagement with Local Authorities	Local Authorities will be presented with this OBC as a proposed path forwards for the establishment of the Public Energy Company. This process will be open to input and comment from Local Authorities, with the preferred option and OBC revised as necessary to support Local Authority objectives.
Confirmation of Commitment to the development of the Public Energy Company	Following any necessary revisions to the OBC, public bodies will review the information available and decide whether to progress with the Project on this basis.
Commercialisation Phase	The initial details regarding commercial agreements start to be negotiated (e.g. level of involvement and nature of commitment of Local Authorities willing to be involved at the outset of the Public Energy Company). Additional market testing may also be undertaken at this stage if deemed to be required or perceived to add value.
Procurement Phase	The commercial agreements are negotiated (e.g. White Label negotiations with third party licensed suppliers) An appropriate White Label Supplier, a third-party energy supplier is selected, and the terms of the agreement concluded.
Final Approval	The Final Business Case and Final Decision is made and final sign off is obtained from all relevant parties.

Governance Arrangements

The Project, up to and including the OBC is being managed by a Scottish Government Project team, on behalf of Scottish Government's interests (maintaining an awareness of the aims and objectives of other public sector stakeholders, primarily through input obtained through engagement with Local Authorities).

As the Project moves into the commercialisation phase, it is likely a dedicated Project Manager will need to be appointed to fully manage the Project and ensure all stakeholders interests are safeguarded to the best of their ability. The Project Manager will have responsibility for Project managing the creation and set-up of the Public Energy Company and the procurement of the partnered energy supply company. Once the procurement approach has been confirmed, it will be necessary to ensure that any procurement processes undertaken are appropriate, including ensuring that the Public Energy Company itself is established at the appropriate time and the procurement is conducted under the appropriate entity.

Timetable

The estimated timetable at time of writing has been set out in a manner designed to ensure the Public Energy Company can be operational by 31 March 2021. The detailed timetable can be seen in the Management Case.

The Project is expected to be achievable, with a dedicated Project manager and staff input into the Project as well as support from specialist legal, technical and financial advisers, as appointed.

2.7 Conclusion

The OBC presents a justification for taking the Project forward to commercialisation stage. The proposed structure of the Public Energy Company is that an active energy supply company will enter into a White Label arrangement with the Public Energy Company for the provision of gas and electricity. The Public Energy Company itself will ultimately need to determine the most appropriate commercial arrangements. However, under the form of a company limited by shares, it is able to generate positive returns that could be used to support reducing fuel poverty in Scotland or be invested into alternative measures to tackle fuel poverty issues.

Based on the work performed, when compared to the Counterfactual position of 'Do Nothing', there is an overall financial benefit for domestic customers switching their gas and electricity supply to the Public Energy Company.

Table 6 - Financial Benefit of Retention Model for the Public Sector

Description	Real £000s	NPV £000s
Net interest generated under the Public Energy Company (Retention Model)	810	624
Net dividends generated under the Public Energy Company (Retention Model)	22,540	12,290
Total benefit	23,350	12,915
Net cash generated under a Business as Usual position	-	-
Benefit to Scottish Government of the Public Energy Company (Retention Model)	23,350	12,915

Table 7 - Financial Benefit of Acquisition Model for the Public Sector

Description	Real £000s	NPV £000s
Net interest generated under the Public Energy Company (Acquisition Model)	83	64
Net dividends generated under the Public Energy Company (Acquisition Model)	5,597	3,272
Total benefit	5,680	3,336
Net cash generated under a Business as Usual position	-	-
Benefit to Scottish Government of the Public Energy Company (Acquisition Model)	5,680	3,336

3 Strategic Case

3.1 Purpose

The purpose of the Strategic Case is to provide the strategic justification for the Project, including outlining the background and associated objectives of the Project, as well as assessing stakeholders, opportunities and risks.

This section is set out in the following key headings:

- Project background – a history of the Project and its development;
- Project updates from SOC to date – a summary of project developments following SOC completion to OBC commencement;
- Drivers for change and opportunities – a summary of some of the key issues in the current market and the opportunities this could present for the Public Energy Company;
- Stakeholders – outlines key stakeholders, the stakeholder events held and the key outputs of those events;
- Market information (including opportunities and risks) - details information about the current market, including new entrants and recent supplier exits; and
- Prioritisation of approach – a consideration of areas the Public Energy Company will need to carefully balance to ensure its success.

3.2 Project background

Following the announcement by the First Minister of the intention to set up a Public Energy Company, a SOC was prepared to consider its development. The purpose of the SOC was to present the case for change for Scottish Government to establish a Public Energy Company, it was published in March 2018 and was developed in line with HM Treasury business case model and guidelines³.

The SOC was prepared to explore the initial options and determine the purpose and feasibility of establishing a Public Energy Company.

The SOC concluded that it is possible to establish a Public Energy Company which could achieve the objectives stated of delivering competitively priced energy to help alleviate fuel poverty in Scotland. Whilst it did conclude that it is possible, the SOC also documented a number of challenges and risks involved in the Project. One of the key challenges noted was the highly competitive nature of the energy market in Scotland and the notably low profit margins (see section 2.1 for further details of the issues highlighted by the SOC). Due to State Aid restrictions, the Public Energy Company would not be able to rely on subsidies and therefore must be able to run as a commercially operated entity in order to be feasible.

³ [The Green Book: Appraisal and Evaluation in Central Government - Guidance](#)

This OBC explores the different options available to explore and further investigate the plausibility of the Project. During the SOC, the four delivery arrangement options considered were:

1) Do nothing

The Project is not pursued and the Public Energy Company is not established.

2) Existing socially minded supplier

The Public Energy Company would utilise an existing socially minded supplier to act as the Public Energy Company into the future. Existing ownership and governance arrangements would need to be reviewed to ensure appropriate control. Per the SOC, there are existing socially minded suppliers in the market who are focused on promoting their social values as a way of engendering trust amongst costumers and encouraging them to switch their energy supply. These suppliers may typically be owned by a Local Authority or housing provider (e.g. Robin Hood Energy).

3) Government owned company

Creation of a new limited company (by shares or guarantee). It would be owned by interested public sector investors and governed by the Companies Act. An example of a relevant entity would be Scottish Water. The public sector investors would appoint the Chairman and Board of Directors to ensure its policy objectives and interests were reflected in the Company Strategy and Business Plan. The Board would oversee the Executive Management Team.

4) Federal model

Creation of an incorporated "Topco" company with joint venture subsidiaries operated by individual Local Authorities. The subsidiaries would White Label the supply of electricity and gas from the Public Energy Company and bring a locally branded supply to the market. The products would be consistent across the Local Authorities. It would be up to individual Local Authorities whether they participated in the vehicle. The top company would be controlled by a Board. Governance arrangements would need to be agreed for the regional subsidiaries, including delegated remit. Funding would be through initial public sector investors (as shareholders) with the potential for third party funding (including through trading profits).

There have been some changes to the options being explored, from SOC stage to date, the reasons for these changes are explained at Section 3.3. The delivery arrangement options which the OBC considers are:

Table 8 – Delivery options

	Delivery option	Description
1	Fully Licensed public sector owned supplier	The public sector owners of the Public Energy Company establishes a Fully Licensed, publicly owned gas and electricity supplier.
2	White Label Supply	This option involves contracting with an existing fully licensed energy supplier, to provide Public Energy Company branded gas and electricity to customers. This partner is chosen in line with criteria determined as part of a formal tender process.
3	Counterfactual: Do nothing	This will provide a baseline and help to highlight the impact of the current situation on fuel poverty.

3.3 Issues highlighted by the Strategic Outline Case

The work performed in the SOC highlighted items for resolution in order for the Public Energy Company to be a success:

- The preferred delivery option needs to be identified. This option must be deliverable by the end of the current parliament, March 2021, therefore the option chosen must be able to fit this timeline;
- It needs to be possible for the Public Energy Company to be self-financing in the longer term (recognising that up-front costs will be incurred and will need to be recouped through trading activity);
- There is little margin on the sale of electricity, and whilst margins are slightly higher on gas, it needs to be proven that the Public Energy Company can provide energy at competitive prices and remain self-financing;
- In a largely disengaged market, the Public Energy Company must be able to encourage customers to switch suppliers, it was noted that a public sector initiative could help in terms of improving consumer trusts to encourage switching;
- Whilst the Public Energy Company must be able to achieve competitive pricing from the outset, it must be able to maintain this over the long term to retain customers;
- Based on the delivery option chosen, it may be necessary to obtain a gas and electricity supply licence. White Labelling would not require this licence as the third-party supplier would hold this and be responsible for meeting regulatory requirements; and
- The Public Energy Company would need to ensure it is aware of and compliant with all laws and regulations. Legal advice will be required to ensure this.

3.4 Project updates from SOC to commencement of OBC

From the SOC to the OBC there have been a number of developments to the potential delivery arrangement options believed to be achievable within the given timescale. The Scottish Government are of the opinion that the timelines for establishing a Public Energy Company by the end of the current Parliament (March 2021) does not provide sufficient time for the procurement and establishment of a Fully Licensed Scottish Public Energy Company.

Additionally, there has been a general acknowledgement of the view that Fully Licensed Supply has greater set-up and ongoing funding arrangements and carries a higher financial and potentially reputation risk than White Label Supply. This has resulted in the shift from exploration of this delivery arrangement from the outset, to considering the potential for the expansion to this type of model from 2023 onwards. However, this delivery arrangement option is described and considered in full in the Economic Case section of this report.

From the SOC stage to the OBC stage, the decision was made to discount the option of pairing with an existing socially minded supplier, this option is therefore not being explored explicitly as part of the OBC. The reason for this was to ensure the Public Energy Company was established in partnership with Local Authorities to maximise the benefits to local communities. It was noted however, that should White Labelling be chosen as the preferred delivery option then the selection process of an appropriate White Label Supplier could, and indeed should, include socially minded suppliers, whilst also ensuring the partner entity is chosen via a competitive procurement process to ensure fairness and transparency.

3.5 Steering Group

It was determined that a Steering Group should be formed who meet throughout the OBC process, providing oversight of the Project. It was highlighted early on that it is considered important to have both COSLA and Local Authority representation on the Steering Group, given the desire for the Project to be a collaboration with Local Authorities. The Steering Group met for the first time on 3 December 2018. The meeting covered the background of the Project to date, as well as setting out the role of the Steering Group, past and planned stakeholder events and a timeline to completion of the OBC.

The role of the Steering Group was to oversee the development of the OBC as well as providing challenge and support as required. A key part of this role was to ensure that any opportunities and risks identified throughout are properly addressed.

3.6 Parliamentary Inquiry

In June 2018 the Economy, Energy and Fair Work Committee launched an inquiry into publicly owned energy companies, its aim was to seek views on the potential role and remit of a publicly owned energy company to help the growth of local and community projects. There were two evidence sessions investigating the perception of the potential role of a Public Energy Company and preferred governance arrangements.

On 14 December 2018, the Committee wrote to the Minister for Energy, Connectivity and Islands with their findings. The letter identified a number of issues and opportunities highlighted by the responses and summarised what it believes to be the key points for consideration of the Project going forward:

- The Committee believes that the Public Energy Company should be an independent body who is accountable to the Parliament;
- It will be important to ensure good governance, policy expertise, cross-party buy in and long-term ownership plans;
- The Public Energy Company should have a clear mission statement, in line with its objectives to provide cheaper energy and the alleviation of fuel poverty. The key objectives of the company should be documented and fit the smart criteria;
- The Public Energy Company should not cut across or undermine any of the 36 current, main energy policies in place; and
- The Public Energy Company should align with Scottish Government's Energy Strategy.

The Committee also noted a number of areas which it would like to see addressed going forward:

- How the Public Energy Company plans to build a customer base, what analysis has been done on this, and how it will take into account Ofgem's price cap on default tariffs;
- The detail of the White Label approach options;
- The parameters of what a Public Energy Company can achieve within state aid rules;
- Whether the intention is for the company to be municipal in character (in the manner of Robin Hood Energy for example) or working more at the state level (e.g. Equinor); and
- The status of the body regarding its independence from Scottish Government and accountability to the Parliament.

3.7 Drivers for change and opportunities

There are difficulties in the Scottish energy market which Scottish Government would like to improve via the creation of the Public Energy Company. The Scottish Government's key driver in the short term for considering the Project is to support the wider agenda on tackling fuel poverty.

3.7.1 Draft Fuel Poverty Strategy for Scotland

A key objective of Scottish Government is to help alleviate fuel poverty in Scotland. The Scottish Government issued a Draft Fuel Poverty Strategy in June 2018 which discusses how eradicating fuel poverty is crucial to achieving a fairer, socially just and sustainable Scotland. The strategy also outlines a number of actions to be taken

to achieving this, including 'establish a public energy company to contribute to tackling fuel poverty and supporting economic development.'

The Scottish Government's current definition of fuel poverty was defined in the Scottish Fuel Poverty Statement (FPS) published in 2002 as, "A household is in fuel poverty if it would be required to spend more than 10% of its income (including Housing Benefit or Income Support for Mortgage Interest) on all household fuel use.". However, this is proposed to be updated to "Households should be able to afford the heating and electricity needed for a decent quality of life. Once a household has paid for its housing, it is in fuel poverty if it needs more than 10% of its remaining income to pay for its energy needs, and if this then leaves the household in poverty." Under this definition an estimated 613,000 Scottish consumers are currently in fuel poverty, which equates to 24.9% of households⁴.

The statistics on fuel poverty in Scotland highlight the issue and the opportunities for improvement. The creation of a Public Energy Company could allow Scottish Government to influence and control unit and standing charge pricing for consumers, however the extent to which this can be controlled will also be dependent on the delivery option chosen.

Helping to alleviate fuel poverty is about reducing prices but is also about educating consumers on energy usage to help them reduce their consumption levels. The Draft Fuel Poverty Strategy sets out how fuel poverty and energy efficiency are linked and therefore, simplistically, by using less energy, those facing fuel poverty can help to reduce their energy bills. Education of consumers can encourage the use of less energy as well as encourage switching which can result in cheaper unit costs and therefore cheaper bills. The Public Energy Company will look to use a combination of these factors to help reduce the fuel poverty levels in Scotland.

The Public Energy Company must consider how tariffs will be set and the number of tariffs available, as well as the criteria the customers must fit to benefit from each. For example, the definition of 'fuel poverty' will be crucial if there is a tariff specifically aiming to help these customers. Means testing may also be required to ensure those on this tariff are the target market. This means testing would require resource to complete, it will be important to ensure, in the case of White Labelling, that the White Label Supplier will provide this service and absorb these costs within the revenues generated from the partnership payments.

3.7.2 Energy Strategy

As published in the 'Scottish Energy Strategy: The future of energy in Scotland'⁵ (December 2017) (energy strategy), there is a 2050 Vision for Energy in Scotland. The vision is to create a 'flourishing, competitive local and national energy sector, delivering secure, affordable, clean energy for Scotland's households, communities and businesses.

⁴ [Scottish House Condition Survey Key Findings - Fuel Poverty](#)

⁵ Scottish Government (2017) – [Scottish Energy Strategy](#)

The energy strategy identified six key priorities as follows:

Table 9 – key priorities

	Priority	Description
1	Consumer engagement and protection	“We will work hard to protect consumers from excessive or avoidable costs and promote the benefits of smarter domestic energy applications and systems.”
2	Energy efficiency	“We will continue to take direct and supporting actions to improve the use and management of energy in Scotland’s homes, buildings, industrial processes and manufacturing.”
3	System security and flexibility	“Scotland should have the capacity, the connections, the flexibility and resilience necessary to maintain secure and reliable supplies of energy to all of our homes and businesses as our energy transition takes place.”
4	Innovative local energy systems	“We will empower our communities by supporting the development of innovative and integrated local energy systems and networks.”
5	Renewable and low carbon solutions	“We will continue to champion and explore the potential of Scotland’s huge renewable energy resource, and its ability to meet our local and national heat, transport and electricity needs – helping to achieve our ambitious emissions reduction targets.”
6	Oil and gas industry strengths	“We will support investment, innovation and diversification across our oil and gas sector, working with industry to advance key priorities such as maximising the recovery of remaining resources, subsea engineering, decommissioning and carbon capture and storage – collaboratively addressing the challenges of today and preparing the sector and its workforce for a positive role in Scotland’s future energy system.”

There are a number of different ways the creation of a Public Energy Company could support these objectives:

1) Consumer engagement and protection

The emergence of new energy companies in recent years has helped to improve competition in the market outwith the six biggest energy companies. For reference, the Big Six suppliers are;

- Npower;
- EON;
- EDF;
- Scottish Power;
- SSE; and
- British Gas.

These new companies give consumers more choice however, some consumers chose to remain with their existing energy provider over the long term and switching rates in Scotland in particular are lower than the rest of Great Britain⁶. There can be many reasons for this, including:

- Brand loyalty;
- Lack of knowledge of the energy market in general, including a lack of awareness of different tariffs, incentives and different payment methods;
- Not knowing how to switch supplier, often coupled with a belief that it is difficult or laborious to do so; and/or
- Having a perception that switching cannot and will not result in lower bills; and/or
- Financial savings are not sufficient enough to drive switching.

Encouraging consumers to switch suppliers to one which best fit their needs is a key challenge for all energy companies and would be a key obstacle for the Public Energy Company to overcome in order to attract sufficient customer numbers. There is an opportunity for the Public Energy Company, as part of its wider role in the Scottish energy sector, to encourage inert consumers to become active, thereby helping to mitigate the potential loyalty penalty⁷ associated with an absence of engagement and switching. In doing so, it can supplement the immediate financial approaches to targeting fuel poverty through its own tariffs with a wider educational and informational aspect of its operations. It is estimated that 8 in 10 billpayers are being charged significantly higher prices for remaining with their existing supplier in at least one essential market⁸. The cost of this work to improve consumer knowledge and engagement will be part of the initial and ongoing marketing costs of the Public Energy Company, these projected costs are set out in section 6.9

To address inertia, potential areas of activity for Public Energy Company could therefore include (not exclusively):

- Engagement with national government departments and bodies such as Ofgem and Citizens Advice to help reduce inertia and promote switching by customers through greater engagement with the energy market, and through the support of both new initiatives and current work by these parties as a means by which to mitigate the loyalty penalty;

⁶ Scottish Government (2017) - [Scottish Energy Strategy](#)

⁷ The loyalty penalty occurs when existing customers, across essential services such as energy and telecoms, pay more for a service than a new customer would be charged.

⁸ [Citizens Advice Loyalty Penalty Super Complaint](#)

- Facilitate understanding of the loyalty penalty, which customers gain from it, which customers lose out from it, and what are the causes of it – doing so through independent research. This can then facilitate specific targeting of vulnerable customers and the fuel poor, given the hypothesis stated above;
- Utilising the same approach, seek participation from energy suppliers to inform and engage with their customer bases, while also promoting or supporting legislative measures that yield enforcement against those businesses responsible for harmful and unacceptable business practices; and
- Provide support to consumers to engage with the energy market through the support of measures such as collective switches, automated switching services, the provision of face-to-face support or facilitating the use of other intermediaries (e.g. price comparison sites) – thereby making comparison of supplier tariffs easier and more transparent.

There are also many schemes relating to energy already in place, including winter fuel allowance and warm homes discount which could be supported and promoted by the Public Energy Company. The importance of protecting vulnerable customers is crucial to Scottish Government and schemes including the Priority Services Register help to provide additional services to those in need.

2) Energy efficiency

One of the aims of the Public Energy Company could be to encourage and promote a reduction in energy usage in order to reduce bills and therefore help to ease fuel poverty. The Public Energy Company could therefore create and promote initiatives to improve public education of energy usage and promote ways in which households could reduce the amount of energy used. This has benefits in terms of both, fuel poverty and environmental impact. This would involve costs however could be integrated or paired with the Public energy Company's marketing spend or could also be a channel for any funds generated to be reinvested into helping to alleviate fuel poverty.

The roll-out of smart meters would also impact energy efficiency and the Public Energy Company. OFGEM projects that 75% of smart meters will be installed by the end of 2020. The delivery option chosen for the Public Energy Company will determine which party is ultimately responsible for the completion of the smart meter rollout. Current legislation places the obligation for completing the smart meter rollout on licensed suppliers. Therefore, if a White Label arrangement is chosen, the responsibility for installing smart meters will lie with the Fully Licensed partner supplier.

Domestic homes having smart meters also provides an opportunity for the Public Energy Company to promote energy efficiency in new ways and use the information smart meters can provide to educate consumers on how to make improvements and savings in their own homes. Similarly, smart meters provide accurate consumption information to suppliers, making billing overall more accurate and removing the need for meter readers or for customers to provide readings. Consumers can also access real time information on this energy usage via an in-home display. This is expected to improve consumer experience of the energy market by reducing estimated bills, meter read requirements, and improving knowledge of energy use.

Additional Energy Efficiency Measures

The Energy Company Obligation (ECO) scheme places an obligation on larger domestic suppliers to support affordable warmth for households through the installation of accredited energy efficiency measures. The ECO is the latest iteration in a long line of energy efficiency programmes delivered by licensed suppliers dating back to 1994.

ECO is a target-based scheme, with responsibility for meeting the overall targets split between all obligated suppliers. Suppliers that supply less than 250,000 are exempt from the scheme, although as with the WHD, participation thresholds are reducing to 150,000 accounts by 2020.

Both White Label Suppliers and Fully Licensed suppliers are obligated to provide these services once they breach the threshold, or their parent supplier in the case of White Label.

In addition to these mandated energy efficiency activities there are likely to be wider opportunities for the Public Energy Company to engage in this segment of the market. ECO is not tied to suppliers' own customers but is based on meeting their overall delivery target. This means that public entities are ideally placed to identify groups of residents who would benefit from energy efficiency measures and taking these to obligated suppliers.

For example, it could potentially combine its current understanding, or that of the Scottish regional authorities, of resident vulnerability with information from suppliers to build a more complete picture of customer vulnerability. This knowledge could either be combined with the ECO obligation to identify potential ECO installation targets or for broader action. This broader action could range from 'thin' measures such as providing a holistic approach to fuel poverty to recycling of profits into energy efficiency installations to directly address issues.

3) System security and flexibility

The creation of a Fully Licensed Public Energy Company would allow Scottish Government to have more influence and control over the reliability of supply. However, of the delivery arrangement options being explored, as noted in the commercial case, the option of creating a Fully Licensed Public Energy Company has been ruled out in the short term. Therefore, the ability to achieve this goal is potentially limited.

4) Innovative local energy systems and

Similarly, the ability to empower communities by supporting the development of innovative and integrated local energy systems and networks may be restricted by the choice of delivery arrangement. If White Labelling was chosen as the preferred delivery method, a focus on the specific terms of the contract and engagement could help to ensure inclusion of terms in relation to these objectives.

5) Renewable and low carbon solutions

A Public Energy Company could be leveraged to support renewable and low carbon solutions in Scotland to a degree. However, as stated above, the ability to support this could be restricted by the choice of delivery arrangement. If White Labelling was chosen as the preferred delivery method, a focus on the ability to sign Power Purchase Agreements (PPAs) with local generators and potential reinvestment of revenues from the Public Energy Company should be considered.

3.8 Off gas grid consumers in the Scottish market

There are a number of challenges which are specific to the Scottish market. A significant area of challenge is the higher percentage of consumers who are 'off grid' for gas in Scotland compared to elsewhere in the UK as a result of the geography of the country and the isolated nature of many of these communities. These households therefore rely on electricity and other sources of energy to heat and power their homes.

Table 10 - Estimate of Scottish households not on the gas grid - 2017⁹

Country	Number of domestic gas meters (000s)	Number of households (000s)	Estimated number of households not connected to the gas network (000s)	Estimated percentage of households not connected to the gas network
Scotland	2,066	2,464	486	20%

Source: BEIS Sub-national estimates of households not connected to the gas network

Additionally, competition and pricing in the energy sector for non-gas customers remains an area of challenge. The majority of supplier tariffs are designed around a dual fuel offering, and in some cases the most attractive tariff and some discounts are not available to single fuel customers.

3.9 Stakeholders and Consultation events

Key Stakeholders

During the development of the Project, a number of key stakeholders have been identified who should be included in the consultation and decision-making process. A list is provided below of stakeholder groups for inclusion in stakeholders events and consultations.

⁹ [Sub-national Estimates of Properties Not Connected to the Gas Network](#)

Table 11 - Stakeholder Groups

Group	Description
Local Authorities in Scotland	Local government
Government	Scottish Government representatives
Fuel poverty organisations	Charities such as National Energy Action
Utility Companies	Existing energy companies
Consumers	Users of heat and electricity

Local Authorities

It was identified early on that the first stakeholder event should focus on Local Authority participation as their involvement is crucial to the success and ultimately, the progression of this Project. Their engagement and participation is fundamental to the creation of a Public Energy Company. The Scottish Government noted at the outset that the aim would be to include representation from all 32 Local Authorities in Scotland.

During the preparation of the SOC, there was minimal Local Authority involvement and therefore there was a focus on ensuring this during the OBC stage. It was determined that a series of stakeholder engagement events should be organised, with the first event aiming to achieve attendance from as many of the 32 Local Authorities as possible. It was recognised that there were certain geographical challenges in Scotland which could prohibit some of the Local Authorities attending.

The formation of a Public Energy Company will rely on support from the Local Authorities and therefore it was deemed imperative from the outset, that representatives from Local Authorities were involved in the process and were able to give their opinions. For the Public Energy Company to be successful, particularly in some of the delivery options being explored, Local Authorities must be involved and onboard. The Scottish Government wanted to gather information that could not be obtained at a higher level, from the people close to their communities.

Given the decision to widen the scope of the Project to include input from Local Authorities, on 28 August 2018, Scottish Government wrote to COSLA inviting the Scottish Local Authorities to work with Scottish Government in developing the Public Energy Company proposition. COSLA have continued to be engaged in the development of the Public Energy Company strategy and are anticipated to input further as the Project moves closer to delivery.

Stakeholder events

Consultation with Local Authorities

The first stakeholder event was held on 27 November 2018. The purpose of this event was to engage with representatives from Local Authorities across Scotland to give them details on the Public Energy Company Project and gather opinions. It was an opportunity to discuss key issues associated with the development of an OBC for a Public Energy Company for Scotland.

There were speakers from Scottish Government, Grant Thornton and Aberdeen City Council, followed by discussions in table groups. Local Authority representatives were asked about a variety of items, including what their communities want and need, and how the creation of a Public Energy Company could help address these needs.

From the discussions throughout the event, below is a summary of some of the key points which have been considered throughout the OBC.

Pricing

- The importance of pricing for the Public Energy Company was highlighted, with a number of 'tiered' structures suggested, including linking pricing to usage (i.e. higher users pay more per unit once past a set threshold). Standing charges were also raised, with some of the delegates present stating they should be scrapped; and
- The conclusion on pricing from the group was that in order to tackle fuel poverty the cheapest pricing must be offered to those households who are 'fuel poor'. It was suggested that the Public Energy Company should be a not-for-profit entity, re-investing any surplus funds.

Customer Attraction

- The number of customers in Scotland who do not or are not willing to switch supplier was highlighted in the SOC and discussed in greater detail at the stakeholder event. Delegates agreed that in order to attract and incentivise customers to switch, the Public Energy Company must be able to teach the public and become a trusted entity in order to encouraging them to switch supplier.
- Renewable energy and carbon reduction were also discussed as issues communities are concerned about. It was noted that the Public Energy Company must have a unique selling point in order to be attractive to customers. It was suggested that the not-for-profit element, whereby surplus profits are reinvested locally, for example into community generation projects, could be the unique selling point.

Delivery Options

- In terms of the delivery options for the Public Energy Company, the workshop discussed the pros and cons of White Labelling on either a local or national level. At a local level, it was noted that customers may trust a Local Authority brand more than a Scottish Government brand, but also that the Local Authorities may not have the resourcing capacity and skills required to implement a Public Energy Company of their own. From a national perspective, there would be economies of scale with a national Public Energy Company able to reduce duplication of some of the work involved that would be incurred were a Public Energy Company to be set up 32 times across each Local Authority. They would also likely to be able to offer more competitive pricing, which has already been identified as key in the success of the Project, by having increased buying power and access to a larger pool of customers. However, regional differences could make it difficult for a centralised national Public Energy Company to meet the needs of all 32 Local Authority areas.

Overall, the event highlighted the need to ascertain what the role of the Local Authorities will be, which will largely be down to the choice of delivery option and the extent to which individual Local Authorities wish to engage with the development and subsequent operation of the Public Energy Company. As such, the OBC clarifies this further through the Economic and Commercial Case and also considers further the opinions of the delegates from this event. Whilst not all desires highlighted from the stakeholder events are likely to be met in the short term by the preferred solution of White Label supply, many are and some are also part of the long-term objectives of the Public Energy Company, as detailed at Appendix A. The issues of encouraging customers to switch and the Public Energy Company being a not-for-profit entity with surplus profits being reinvested into helping alleviate fuel poverty have been detailed in the Strategic Case and are a key focus of the Project.

Following on from the stakeholder events a further engagement session was undertaken on 30 May 2019 with SOLACE involving local authority Chief Executives and Senior Managers. The Chief Executives were provided with details of the draft OBC and were asked to respond as to their level of interest in the emerging public energy company. As part of the discussions Chief Executives expressed an interest in exploring the additional option of utilising or developing a switching app to help consumers identify competitive energy pricing options that could reduce their consumption costs.

Other Stakeholders Consultation

A second stakeholder event was held on 16 January 2019, with representatives from Scottish Government, Grant Thornton, Cornwall-Insight and Ecuity present. The purpose of the event was to discuss key issues associated with the development of the OBC for a Public Energy Company for Scotland, with a range of stakeholders from various sectors, including energy, education and housing.

From the discussions, it was noted that the stakeholders believe the top 5 community wants and needs to be as follows:

1. Low Price – However, sustainability of price over time may be more important than absolute lowest in market from the outset;
2. Support for environmental objectives;
3. High level of customer service – it was noted an online only presence only would not be sufficient therefore the ability to answer customer calls from a manned call centre would also be required;
4. Pool of experience for the Public Energy Company within Local Authorities and Communities; and
5. Support for fuel poor households.

Whilst point 5, supporting fuel poor households, is a fundamental aim of the Public Energy Company in the short term, pricing will be required to be competitive in order to achieve this as already noted. In terms of the costs of customer service provision, in the case of White Labelling, these costs would lie with the White Label provider. The support for environmental objectives would likely fall into a longer-term goal due to the current time and scope restraints, however, addressing environmental concerns has been noted as a future objective of the Public Energy Company. Summary documents outlining each stakeholder event are included in the appendices.

3.10 Market information (including opportunities and risks)

3.10.1 New entrants to the market

In recent years, there have been a number of new entrants to the energy market, some of which have subsequently ceased to operate, and others which continue to trade. The wholesale prices of gas and electricity are crucial in the success of new entrants to the market.

We observe that wholesale markets have been relatively benign following the economic crash of 2008 – although they have been more volatile since winter 2016 and were on an upward trend for much of 2018. This coincides with the timing of the flurry of new energy companies to the market, including some which are publicly owned. New entrants were able to take advantage of generally falling wholesale prices by passing them onto customers more quickly than the established players. This is because the nature of the energy sector and energy procurement means that larger, more established energy companies enter into contracts, often years in advance, to secure supplies in accordance with their market hedging strategy.

While market conditions are good, and wholesale prices for gas and electricity are falling, this is an advantage for new entrants as they are able to buy at lower prices than the more established suppliers, who are committed to the pre-arranged contract secured in line with their hedging strategy. However, the other side of this means that when wholesale prices are rising, new entrants pay more for their supplies and therefore struggle to offer competitive pricing in order to attract customers.

The key difficulty for new entrants is that when prices begin to rise, they face more difficulty in securing forward contracts for the procurement of their supply. This is due to a number of factors including relations built with suppliers over time and credit ratings. It is therefore extremely important for the predicted trends and current patterns of wholesale energy prices when determining the feasibility and delivery options for the creation of the Public Energy Company if a Fully Licensed Supply model is progressed.

Another factor which could be attributed to the success of some new entrants to the market is the continual political and media scrutiny on the Big Six suppliers since 2008.

As a consequence, the 'Big Six' have been cast as offering expensive products and poor service, although it should be noted that this perception is not only limited to the Big Six. This has however, allowed new players to the market to capitalise on the low (although now improving) perceptions of the established players.

3.10.2 Supplier exits

After a period of relative inactivity in terms of supplier exits, the retail market has seen an increase in the level of supplier exits in recent years for both domestic and non-domestic suppliers via a number of different routes.

There are two main routes which suppliers typically exit the market via, these are:

- Trade sales – the 'conventional' route to market where a supplier operating in the GB market is purchased as a going concern; or
- Supplier of Last Resort (SoLR) – the Ofgem SoLR mechanism transfers a supplier's customers to another supplier if the supplier collapses and is forced to exit the market. Unlike in a trade sale an SoLR is only invoked if a supplier has failed and ceased trading. Ofgem holds a competitive process and appoints a supplier it considers best able to take on the customers and has provided the most competitive offer. The supplier who gains the customers can recover a proportion of the costs they incur from a socialised industry levy.

In the period from February 2018 to December 2018, Ofgem noted 13 supplier exits¹⁰. The main reason for supplier SoLR exits in recent years has been due to suppliers' inability to recover sufficient revenues via their customer base to meet raising costs. This has been driven by a number of factors in the market, including: wholesale price spikes; discounted tariff offers set at a level that is unable to recover parties' costs, and rising non-energy costs faced by suppliers (for example network costs, smart meter rollout costs, policy costs) Ofgem's default energy tariff price cap¹¹ can also impact upon this, limiting the ability of suppliers to raise prices on customers to offset losses on pre-existing customer contracts. Trade sales have been a mix of forced exits, such as Flow Energy, and parties exiting the market to achieve value, such as Opus Energy and First Utility.

¹⁰ Company websites, Ofgem, Cornwall Insight analysis

¹¹ Ofgem – [Energy Price Caps Resources Library](#)

For any potential new entrants to the market, this trend of supplier exits and the reasons for such exits should be considered fully to ensure the same issues are not repeated. On 25 January 2019, the board of Our Power Energy Supply Limited (Our Power) took the decision to close and the company entered administration. One of the key impacts of this is that they were the White Label Supplier to Hebrides Energy, whose customers were switched to Utilita under the Supplier of Last Resort (SoLR). Hebrides Energy will need to consider who the appointed supplier is and negotiate the terms of the new contract. The reasons cited for the collapse of Our Power include lack of funds due difficulties in billing customers and therefore timely collection of cash. This disparity caused the company to have insufficient funds to continue. It is clear that the Public Energy Company, if progressed to a Fully Licensed Supply option, will need to ensure it learns from the difficulties faced by Our Power to avoid these issues.

Following these exits, Ofgem has undertaken a review of the supplier licensing rules and introduced a more stringent entry regime for new suppliers. This includes greater scrutiny of financial stability, confirmation of suppliers' ability to deliver their regulatory obligations, and a more detailed – and hence longer – review process.

3.10.3 Re-municipalisation of energy

A recent trend in the retail market has been the growing interest from public bodies in taking a more active role in the energy markets. The reasons behind this are many but can be summarised as seeking commercial structures to offer tailored energy tariffs to support local residents and businesses (of notable relevance to the Public Energy Company); as a means to facilitate development of and extract value from local low-carbon generation; and potentially seeking an additional revenue stream as funding is removed.

The primary models adopted to date include Fully Licensed supply (e.g. Bristol Energy, Robin Hood Energy), traditional White Label supply (e.g. Peterborough Energy, Qwest Energy etc.), an emerging move towards 'White Label Plus' (White Rose Energy) and the development of private wire/network solutions often incorporating heat networks. Additional information on these options is presented in the Economic Case.

The rationale for establishing these suppliers has been the argument that they will be able to leverage their reputation and familiarity to attract customers otherwise unlikely to switch. Rather than trying to attract those customers that frequently switch by providing discounted competitive offerings, their strength is that they have the potential to attract those customers who are otherwise reluctant to switch and will view the public supplier as a more safe and recognisable service provider for this essential service.

Local suppliers often do not seek to be the cheapest on the market, but price products that will still save the disengaged and vulnerable customer segments significant amounts compared to be served by the local incumbent. For example, Bristol Energy stated on its website that, "We save our customers on average around

£200 per year on average on their energy bills,” although it gives no explanation of exactly how it has derived this figure¹².

3.11 Prioritisation of approach

Price and Service

A key consideration the Public Energy Company will need to address is the balance between competitive pricing and the level of service being offered. The level of importance each individual consumer will place on each factor will vary, therefore it is important to try to achieve the correct balance. Whilst pricing is key in helping to alleviate fuel poverty, service is crucial to attracting and retaining a customer base.

There are various suppliers in the market who offer minimal, skeleton customer service, often only available to contact online, however this allows them to keep overheads down and thus they can market that this saving can be passed on to consumers via unit prices and standing charges. On the other hand, many consumers place more importance on service and are willing to pay more for this. In particular, some consumers place value on being able to speak to a person directly, usually via the telephone. As a publicly owned entity, reputation will also be important to the Public Energy Company so this reputation cannot be risked by offering sub-standard service in order to keep pricing competitive.

It should be noted that if a form of White Labelling is chosen, the provision of customer service will fall to the third-party White Label Supplier. It is therefore key that the selection of an appropriate supplier considers the level of service the supplier provides, with corporate values including socio-economic and environmental policies that align with the Public Energy Company. An example of a White Label arrangement is M&S Energy, who until September 2018 provided energy to its customers through a White Label agreement with SSE. In September 2018 they switched this agreement to Octopus Energy, citing them as having aligned values with the ambitions of M&S Energy, including transparent pricing and digital-first customer service.

The Public Energy Company should carefully consider their selection of a White Label Supplier, if White Labelling is chosen, to ensure they have aligned values with those of the public sector investors, as well as values the target customers would approve of and get on board with. It should also be noted that the customers belong to the third-party White Label Supplier, in this case SSE, M&S Energy therefore encouraged and incentivised customers to move to with them to Octopus Energy. The Public Energy Company should therefore bear in mind that the customers belong to the third party supplier and thus when the White Label Agreement ends, customers remain with this supplier. They can however be encouraged to switch. This point is also important if the Public Energy Company was to become a Fully

¹² [Bristol Energy – Our Quarterly Updates](#)

Licensed Supplier in the future as the same situation would apply whereby customers would need to be encouraged and/or incentivised to switch.

3.12 Long Term Aspirations of the Public Energy Company

The initial objective of the Public Energy Company is to help to alleviate fuel poverty. In order to do so it considers the four drivers of fuel poverty:

- Cost of fuel;
- Household income;
- Energy efficiency in the home; and
- How energy is used in the home.

As covered in the main body of the OBC, securing fair prices for consumers and encouraging switching through education of consumers will be key focusses from the outset. Working to improve an individual's position against the four drivers of fuel poverty will, in the long term, be the best way of working to help reduce fuel poverty levels.

In addition to the short-term goals of the Public Energy Company and how it is set up to deliver against these, there are also long-term objectives for the Public Energy Company and also objectives it may wish to pursue going forwards.

During the preparation of the OBC, a number of suggestions have been made for the long-term outlook and goals of the Public Energy Company, this appendix summarises those. These have come from a variety of sources, including stakeholder events, input from the Steering Group, and the parliamentary enquiry to seek views on the potential role of a Public Energy Company.

Long Term Goal – Addressing climate breakdown and utilising renewable energy sources

Throughout the OBC process, numerous stakeholders have expressed an interest in the Public Energy Company utilising its position to be able to introduce measures aimed at raising awareness of and combating climate breakdown.

In Scotland, where the green credentials of generated energy is increasingly important both to policy makers and consumers, as well as consumers being ever more aware of their environmental impact, being a 'green' energy company that is seen to support and promote renewable energy, as well as taking an active role in combating climate change was seen as essential to remaining relevant and being able to support governmental aims in the renewable agenda.

The Public Energy Company should, long term, have the capacity to invest in and capitalise on Scotland's natural advantage in renewable energy resources and expand into a generation role as opposed to just a supply. Alternatively, if it does not wish to enter a generation role it could look at ways to support it. It could also look to develop methods in which to use excess wind and solar power to provide free hot water storage, perhaps specifically to those in fuel poverty. This may, in the first

instance, not be within the capacity of the Public Energy Company as a White Label company, however this should not preclude from either

- a) In future transition to a fully licensed generation and supply arrangement to allow it to more easily pursue this objective; or
- b) Ensuring it's governance structure is positioned in such a way that surplus profits from operations can be utilised in the pursuit of furthering this goal.

Additionally, in the future the Public Energy Company could explore district heating options to help reduce CO2 emissions and long-term overall costs of energy.

It was also suggested there could be potential to explore liaising with the Scottish National Investment Bank who could offer loans to new renewable energy projects – although whether the Public Energy Company itself would want to explore this or support local projects in pursuing their own applications would need to be defined in future.

Providing support to off-grid customers

Particularly in the Scottish market, there are higher levels of consumers who are off the mains grid and rely on other sources of energy, which are typically more expensive. This can be more laborious than traditional supply and can also be less reliable. There is scope for the Public Energy Company to utilise its profits from operations to invest in appropriate infrastructure to improve the options and quality of service available to these consumers. This could be an expensive investment however, there is a notable value-add opportunity in this area.

Streamlining and consolidation of existing energy policies

In Scotland, there are currently 36 active energy policies. There is an opportunity for the Public Energy Company to bring these together, seeking to 'unify' their impact on the market. Conversely, if not structured appropriately, there is a risk that the Public Energy Company could become a '37th'. Focusing on aligning the objectives of the 36 policies into a coherent and understandable plan could be done and promoted by the Project. In particular, by being in partnership with Local Authorities, the Public Energy Company would also be well positioned to support local and community projects, as well as piloting new schemes.

Broadening of target market

Initially, the Public Energy Company is looking to support domestic households in Scotland, identifying these as its target market. However, it is recognised that there are other energy users that the Public Energy Company could look to target in future. A key identified source of energy users is the buildings across the public estate. The Scottish Government negotiate a 'Public Energy Contract' which covers public sector buildings. It is a 5-year contract, currently held by EDF, having been signed in 2018. However, in future there could be potential scope to expand the focus from domestic households and to include commercial premises and possibly public sector buildings, although it is recognised that procurement regulations etc. would need to be honoured if such an opportunity were to be pursued.

Other

A number of other suggestions have also been suggested by various sources, outwith those described in the headings above:

- Whilst the initial objective of the Public Energy Company is to focus on gas and electricity for domestic customers, there is potential in the future for this scope to expand to cover other areas including small and medium sized enterprises.
- To utilise the rapidly growing opportunities and challenges surrounding the collection and use of data. There is potential to use data sets to support vulnerable and fuel poor customers, thereby supporting the main initial goal of the Public Energy Company to alleviate fuel poverty. This opportunity has been greatly progressed with the roll out of smart meters, as discussed in the Strategic Case.
- Expansion of tariffs and price offering from initial point of set-up – It was suggested that there is the potential to expand the tariffs available in the future, for example, to include a 'high-use' tariff. This could charge higher rates per unit above a certain point of usage, with the additional amounts going towards helping the fuel poor. However, this could be seen to penalise those who have a requirement to use more energy for whatever reason, therefore it would be a tariff that would need to be structured appropriately, with various exemptions in place.
- To pursue longer term PPAs (Power Purchase Agreements) with 'a more social objective' – this could have a particular focus on the sources of energy being provided by the Public Energy Company's energy supplier – for example a commitment to provide energy utilised by the Public Energy Company's users from renewable energy sources.
- To investigate opportunities presented by blockchain infrastructure, which would allow the Public Energy Company to trial and potentially roll out an energy trading platform for solar and wind power generators (residential and SMEs). There is an example of this run by Australian-run firm Power Ledger in Thailand.

3.13 Conclusion

In summary, the Public Energy Company is setting out to help alleviate fuel poverty in Scotland. The strategic case has highlighted the need for change, including the low current levels of customer switching and the number of households in Scotland facing fuel poverty. Stakeholders have been consulted and involved through the delivery of stakeholder events, to promote engagement and gain an understanding of what communities want and need.

The energy market is not an easy market to operate in, with low margins, and the recent number of supplier exits has highlighted this as well as lessons to be learned. The Public Energy Company will need to ensure it has the ability to deliver competitively priced energy to customers both in the short and long term as well as guaranteeing excellent customer service to customers in order to be a success. The delivery options available in order to achieve this will be considered further in the Economic Case section of this report.

4 Economic Case

4.1 Purpose of the Economic Case

This Economic Case considers the objectives of Scottish Government in delivering a Public Energy Company against the current energy market and policy environment. It presents the proposed delivery options for the Public Energy Company and how these have been chosen, reflecting the original SOC and input from public engagement events at which input from key stakeholders was obtained.

It then discusses the criteria against which each of the chosen delivery options have been assessed, before presenting an appraisal of the options to reach a preferred option. This preferred option has then been subject to economic modelling and a risk assessment performed.

4.2 Strategic options under consideration

The March 2018 SOC presented a shortlist of four delivery options for the Public Energy Company. The original shortlist of delivery options served as the basis for discussion at the two public engagement events at which the potential approaches for the Public Energy Company were discussed.

As noted in the Strategic Case, these options were refined in developing the options being considered in this OBC. A detailed summary for each option is presented below.

Additionally, as outlined in section 3.9, SOLACE Chief Executives expressed an interest in exploring the possibility of utilising or developing a switching app to help consumers identify competitive energy pricing options that could reduce their consumption costs. This approach will be explored further with Local Authorities during the next phase in the development of the public energy company.

4.2.1 Option 1: Fully Licensed Supply

This is the conventional route to market for new entrant suppliers. In this case, the Public Energy Company would have the ultimate responsibility to comply with the industry codes and customer-facing obligations set out in the licences.

As the most complex of the market entry options, Fully Licensed supply is generally the most expensive and difficult to achieve, and therefore higher risk, than the White Label route discussed below, but it is more flexible and would grant full autonomy and the most effective route to influencing the local energy market and achieving wider social, economic and environmental outcomes over the long term. It could also provide the opportunity for the Public Energy Company to act as the umbrella organisation to provide White Label partnerships to individual Scottish Local Authorities.

Becoming a Fully Licensed supplier of both gas and electricity to households and businesses (including potentially Scottish Government's estate) represents the "deepest" option in terms of taking a fully active presence in the energy retail markets.

Fully Licensed supply is the conventional approach for energy companies entering the market, although it is a time-consuming process which typically takes 12 – 18 months to complete from go-live and so is unlikely to be deliverable within the specified timeframe for the Public Energy Company.

Additionally, following the new license application approach introduced by Ofgem we would expect the required timescales for market entry to increase. This is due to a longer application process and restricting the ability for off-the-shelf suppliers to complete market entry steps prior to 'go-live'. The required timelines will also vary depending on whether the Public Energy Company was progressed using an off-the-shelf supply license or the establishment of a new company. Bristol Energy entered the market in November 2015 after the Council decision in February 2015 using an off-the-shelf supply license, although this decision was preceded by work with external consultants and internal review and considerations.

A Fully Licensed supplier requires two systems to operate in the GB market. These systems are highly specialised for the energy industry and so expensive to procure. However, as it is the most commonly used route to market there exist around it several support services provided by specialist firms to ease market entry. These systems are:

1. Customer Relationship Management (CRM) and billing system – this is used to track interactions with customers and the billing process for them. These are normally specialised systems designed for the GB energy industry due to the complex nature of customer interactions and the level of regulatory requirements for customer interactions.
2. Industry facing system – also known as industry flow systems – this is the set of systems needed to interface with the central industry systems and submit and receive the necessary data items to enable the industry to function. This includes the data flows ('d-flows' in the industry parlance) necessary for switching customer accounts, and those for the settling of electricity volumes consumed. Again, these are typically specialised systems designed for the GB energy industry, given the complex nature of the requirements and the need for them to undergo validation by the central industry service providers prior to be approved for use

The cost of these systems depend on a number of factors, including

- the targeted customer base;
- potential growth rates;
- system provider chosen; and
- the negotiation process.

Typically, for a new entrant domestic supplier, targeting a potentially large customer base would be in the range of c. £150,000 to £200,000 up front purchase fee for

each of the two systems and a similar yearly licensing fee for each of the systems. However, following the implementation of the new supplier license application process by Ofgem we would expect these costs to increase as entry is now more a 'hands on' process with less opportunity to outsource to systems providers. Therefore, we would consider it would be prudent to assume costs of £200,000 - £250,000 per system. This would normally be expected to scale upwards as the customer base increases, with charges levied on a per meter basis.

The overall costs of market entry as Fully Licensed Supplier as a public body are estimated to range between £2.5mn - £4.0mn (excluding working capital which will be needed for market entry), with the exact figure dependent on ambition (including growth rates, 'non-standard' offerings such as flexibility provision) and target market (such as domestic or business only, and half hourly provision).

The working capital requirements for a new entrant supplier are relatively low, based on the assumption of timely billing of customers (and timely payment by those customers). To avoid a potential funding shortfall, the supplier might need to hold an additional £3.5mn in working capital to meet any differences between revenues and external costs. Additionally, the company will need further cash available to set-up the business and meet its own overheads, that again reflect its ambition and growth targets.

One of the primary requirements for new entrant suppliers, and hence one of the major costs that they will incur, relates to credit. Suppliers must post credit for balancing and settlement, and network charges under industry codes, with wholesale trading partners, and under renewables schemes such as the Contracts for Difference.

Credit requirements for 100,000 customers would be expected to be around ~£7mn during the winter months, including power and gas trading requirements (assuming credit requirements of meeting 30 days of delivery, as per standard trading terms and industry obligations).

Beyond these significant standalone costs, there would also be a number of other required costs that would need to be factored in. These include but are not limited to:

- consultancy and legal support to establish the supplier (potentially in the region of £0.5mn to £1mn);
- the Project Management team required to establish the supplier;
- initial staffing costs; and
- overhead costs such as leases and IT equipment.

Against the backdrop of this outlay and ongoing obligations, it should be noted that suppliers typically are loss making for their initial years of operation – during which time they seek to grow their customer base to defray their fixed costs. As an example, the local authority backed Fully Licensed suppliers Robin Hood Energy and Bristol Energy have been loss making for much of their operations.

Robin Hood Energy was funded by an initial £11m loan and has been funded to a total of £25.5m by Nottingham City Council. This has been to support operations,

with it reporting losses of £2.5m in 2016 and £7.2m in 2017. Similarly, Bristol Energy has been funded for £36m (including commitments) by Bristol Council and reported a loss of £11.2m and £8.4m in the last two years, delaying its forecast profitability date to 2021. These loans have been provided at commercial rates, and Cornwall Insight understands the rates for Robin Hood Energy and Bristol Energy being set at 11% and 8.5% respectively by the establishing Councils.

In addition to these system fees, the Fully Licensed supplier would also face a number of other costs related to market entry, including: for credit and collateral provision for wholesale trading and under the industry codes, significant operational costs, additional systems including trade capture, hedging and forecasting, and legal and consultancy support fees for the establishment of the supplier, not to mention the increased procurement costs associated with a significantly more complex proposition than under the White Label Supply approach.

Under this approach all compliance requirements would sit with Scottish Government, as does the control over how the entity contracts with industry third parties (e.g. metering providers, wholesale counterparties, system providers etc.) and the products and services it offers to end consumers and local generators.

It should also be noted that a holder of a supply licence is required to sell energy across the entire GB market – there is currently no “local” licence that could be pursued for the Scottish market alone. However, comparisons may be drawn with Bristol Energy and Robin Hood Energy which while launched for their home areas have offered, and seen take up, nationwide.

This ability can be seen as a positive, as it provides access to a larger potential customer base, although the need to retain the ‘core’ appeal and brand of the Public Energy Company must be remembered. Additionally, while the Public Energy Company would be required to undertake national supply, it would be possible to offer specific tariffs for the Scottish region, these could be designed to better reflect Scottish usage types or limit the social tariffs to Scottish consumers.

Both have been created by Local Authorities and become operational in recent years. A number of Bristol Energy's customers are outside the Bristol area, and the company has responded to this with the launch of a My Bristol tariff exclusively for customers with a Bristol postcode.

4.2.2 Option 2: White Label Supply

Traditional White Label partnerships have been adopted by several Local Authorities – typically those of a smaller size – across Great Britain, but are often viewed as a less attractive option compared to FLS or the more advanced “White Label plus” option (that is considered in this OBC), particularly for larger or more ambitious councils or at the national level. This is because of the limited flexibility and control over the supply offering under traditional White Label supply compared to the other options, and the reduced ability to capture and deliver wider objectives, such as air quality or low carbon generation deployment. There is no direct barrier to larger parties becoming White Label Suppliers, however as part of the appointment process the ability of the partner supplier's systems to support the potential level of

growth that could be delivered by the Public Energy Company without compromising on customer service should be assessed.

They are most valuable for organisations seeking to enter the market who are resource-limited and wish to avoid exposure to risks within wholesale markets and the central trading arrangements but still develop a unique brand, suitable to local needs.

To date, White Label arrangements have been little more than sales commission-splitting arrangements with Local Authorities for using their relationships and brands with local householders to help the established supplier acquire customers.

As such, we would expect that a Public Energy Company White Label would have greater similarities with a “White Label plus” offering, under which the Public Energy Company is more involved in the customer management, including potentially handling in-house a wider range of activities and receiving a longer-term income stream from the arrangement.

The expectation is that the arrangements also provide greater benefits to White Label customers in terms of price guarantees, given the objective of tackling fuel poverty.

There is an element of flexibility accorded by a White Label supply in terms of the different operating and ownership structures – these being noted from the public engagement events – which may be developed to reflect the wider aspirations of participant public sector entities.

Decentralisation may prove beneficial in allowing Local Authority participation – and potentially an element of control – in the Public Energy Company. This was noted in the SOC federal model and in the feedback from the public engagement events, which included that such a structure could serve the dual benefits of mitigating risk and facilitating customer engagement at the local level. Here:

- The Public Energy Company is established and managed by a consortium of the interest Public Sector bodies, having chosen a suitable White Label partner via a formal tender process;
- The management of the Public Energy Company could then work with the participant Local Authorities to establish their own energy supply activity within this White Label on a consistent, cross-boundary basis;
- Such locally focused suppliers would operate as affiliates to the White Label, this serving as an umbrella organisation; and
- Although the owner and founder of the White Label agreement, the Public Energy Company may not itself act as a public-facing White Label Supplier, this being undertaken by up to 32 participant Local Authorities.

Alternatively, Local Authorities could set the objectives and strategic direction of the Public Energy Company, according Local Authorities a greater role in shaping the development of the company to react to local demands as they arise. Here:

- The Public Energy Company is established and managed jointly by the public sector, including up to 32 participant Local Authorities, having chosen a suitable White Label partner in line with criteria determined as part of a formal tender process;
- The ownership and control structure would need to be agreed as part of the establishment of the Public Energy Company to ensure that a suitable balance between participant Local Authorities.

As a well-known and well-practiced route market, including for individual Local Authorities, White Label supply is considered as a single option given that – as stated – there are a number of iterations in terms of ownership and control.

4.2.3 Option 3: Do Nothing

The delivery options for the Public Energy Company must be considered against continuing business as usual and not engaging in energy supply, taking no further steps beyond its current pursuit of programmes to improve energy efficiency and alleviate fuel poverty.

We consider that these programmes would continue regardless of whether Scottish Government sets up an energy supplier or not, and so are not given specific value. Engaging in the energy market certainly brings both setup costs and continued operational costs, as well as the potential for reputational damage if things go wrong (we note discussion in Holyrood regarding Scottish Government’s support for Our Power, as discussed below). However, the opportunities that may be missed from not entering the market are considerable.

These come in three forms:

- Financial risks, where Scottish Government has and Local Authorities have no opportunity to capture local energy spend revenue to use it to deliver desired outcomes, including improved conditions for local residential and commercial consumers (i.e. social tariffs for vulnerable consumers or social programmes);
- Social, economic, and environmental ambitions (i.e. desire for more generation and community ownership of this in Scotland, or addressing energy efficiency and fuel poverty issues) are not realised over the long term;
- Reputational risk, where local stakeholders, residents and investors perceive that Scottish Government does not have the appetite to be innovative, considering the wider policy objectives it is pursuing; and

For completeness, and to serve as a counterfactual, this is retained as an option for the purpose of this revised assessment of the options.

4.3 Delivery options

These options and their main characteristics are presented in the table below, these being evaluated in line with criteria based upon the stated objectives of the Public Energy Company. As explained in the Strategic Case (section 3.4) there has been some progress from the SOC stage to the OBC in the options being considered.

Each of the proposed delivery options is assessed against evaluation criteria, these being based upon the stated objectives of the Public Energy Company. In applying these criteria, the aim is to compare each of the options on a like-for-like basis to yield the preferred option for the creation of the Public Energy Company.

The criteria are broken down into two groups – mandatory and discretionary criteria – with the latter group assigned weightings based upon their perceived importance to the Public Energy Company as stated by Scottish Government representatives and in official reports and policy documents in the public domain.

Given the integrated nature of Scottish energy policy (as well as policy commitments as a whole), there is an inevitable element of interconnectivity between the discretionary criteria. However, these have been sub-divided where possible to provide an element of delineation across the different criteria.

Table 12 - Delivery options for the Public Energy Company

	Delivery option	Description	Ownership and governance
1	Fully Licensed Supply	A Public Energy Company would be established by the Public Sector as a licenced gas and electricity supplier with full responsibility for complying with the associated industry codes and regulatory requirements.	100% owned and governed by the public sector.
2	White Label Supply	<p>This option involves contracting with an existing licensed supplier, to provide branded and tailored energy tariffs (electricity, gas, and dual fuel) to residential customers. This Fully Licensed White Label partner is chosen in line with criteria determined as part of a formal tender process.</p> <p>The Public Energy Company is established by the public sector partnering with an existing licensed supplier, thereby enabling a central government-backed supplier (potentially in conjunction with LA partners) to provide tailored and branded energy tariffs (electricity, gas, and dual fuel) to residential customers in its area.</p> <p>We assume that there may be a desire to establish a “White Label plus” arrangement, allowing more involvement in customer management, including potentially handling in-house a wider range of activities and receiving a longer-term income stream from the arrangement. The expectation is that the arrangements also provide greater benefits to White Label customers in terms of price guarantees.</p>	<p>To be confirmed.</p> <p>The company may be wholly or part-owned by public sector investors.</p> <p>Governance would then reflect the ownership structure in place.</p>
3	Counterfactual: Do Nothing	Continue with existing policies and do not take any supplemental effort to establish energy supply activity in Scotland.	N/A

4.4 Evaluation criteria and success factors

4.4.4 Summary and overview

The discretionary criteria against which each of the revised delivery options for the Public Energy Company have been assessed are presented below

Each of these individual criteria have been assessed by Scottish Government and their advisory team to determine how these criteria should be weighted to reflect their overall importance.

The performance of each of the delivery options for the Public Energy Company is then scored on an integer basis (1 to 10 in ascending numerical order, where 1 indicates a “weak” performance and 10 an “excellent” performance.

Scorings and weightings are presented in this section as an arithmetic average of the individual scores of Scottish Government’s advisers only, i.e. no explicit scoring was undertaken by Scottish Government for inclusion in this analysis.

Table 13 - Scoring for the delivery options for the Public Energy Company

Category	Description	Score
Weak	The stated option yields a poor outcome, and while it partially addresses the stated objectives, it is subject to major deficiencies	Between 1-2
Fair	The stated option partially satisfies the requirement, it is subject to minor deficiencies	Between 3-4
Adequate	The stated option meets acceptable quality but remains basic and adds little beyond the minimum acceptable outcome	Between 5-6
Good	The stated option satisfies requirement and exceeds minimum expectations of delivery, including the provision of added value	Between 7-8
Excellent	The stated option is comprehensive, innovative and exceeds expectations	Between 9-10

4.4.5 Mandatory criteria

There are two “stop-go” criteria in examining the revised delivery options for the Public Energy Company.

- The chosen option must be capable of being fully implemented and be operational no later than March 2021.
 - The Scottish Government has stated that, “The aim is to have the new company set up by the end of the current Parliament (2021),” and therefore any option(s) which is not capable of meeting this deadline cannot be considered without an extension to this deadline.

- The chosen option must be capable of being implemented without any breach of State Aid legislation.
 - To ensure compliance with State Aid legislation, the chosen delivery model must not operate on a subsidised basis, necessitating the creation of an entity that operates on a commercial basis.
 - It would be expected that this would be reflected in the level of tariffs that it offers, and although explicit underwriting of the Public Energy Company would not be possible, it may be able to accept a lower rate of return than a privately-owned supply business.

Failure to comply with one or both criteria will result in the chosen option being excluded.

4.4.6 Targeted criterion 1: Fuel poverty

The ability to mitigate or reduce fuel poverty among the population of Scotland is viewed as the primary objective of the Public Energy Company, echoing policy statements made to that effect. Opportunities for the public energy company to reduce fuel poverty can include, but may not be limited to, areas such as the ability to offer targeted or cross-subsidised tariffs, funding for initiatives to improve energy efficiency, interaction with housing policy, and engaging with otherwise disengaged customers currently on the highest tariffs etc.

The headline focus of alleviating fuel poverty will be in reducing expenditure on energy, as presented in Scottish Government’s June 2018 Draft Fuel Poverty Strategy¹³ and its efforts to reduce the fuel poverty gap¹⁴. In the first instance, it can be assumed that the public perception of how this could be achieved would be through low cost tariffs.

The tariffs set by the Public Energy Company need not necessarily be the lowest on the market, but they would need to be lower than those paid by currently disengaged customers under a “do-nothing” scenario.

While there may be groups of readily identifiable individuals in fuel poverty such as those in the social housing sector, statistics at the national level indicate that the level of fuel poverty is in fact highest in the private rented sector¹⁵. Therefore, such groups should not be overlooked in the wider policy context when considering customers the Public Energy Company can target alongside the broader retail market.

As an initial foundation for a customer base, and as raised at the public engagement events, social rented homes could be automatically switched to the Public Energy Company when they are voided each year. This would of course be subject to any

¹³ [Draft Fuel Poverty Strategy for Scotland 2018](#)

¹⁴ The differential between the amount that a household currently spends on heating and electricity and the expenditure associated with no longer being in fuel poverty

¹⁵ [Annual Fuel Poverty Statistics Report 2018](#)

existing contractual arrangements already in place for the voids and the undertaking of a procurement process

From a cost perspective, for this criterion we therefore consider the ability of the Public Energy Company to offer socially minded tariffs and to target a suitable customer base. It is also apparent that the regional differentials in the rates of fuel poverty and switching lend themselves to a targeted, regional strategy – potentially with Local Authority involvement.

As can be seen from the Counterfactual, detailed in the Financial Case, the Public Energy Company has the potential to help alleviate fuel poverty in two ways:

- 1) By reducing customer energy bills, resulting in direct cost savings; and
- 2) By using the surpluses generated, as forecasted by the Financial Model to fund projects and schemes to reduce fuel poverty.

4.4.7 Targeted criterion 2: Greater consumer choice

The provision of greater customer choice is not solely about the Public Energy Company entering the market as an alternative to other suppliers. This objective should also encompass efforts to encourage energy market participation and illustrating the benefits of doing so, whether by choosing the Public Energy Company as a supplier or switching supplier in general.

As discussed in the Strategic Case, the extent to which customers switch energy supplier is commonly used as a proxy for their engagement with the sector. Here, the ability of the Public Energy Company to address customer inertia, i.e. the way in which habit, familiarity with a given supplier or inattention to the wider supplier landscape may discourage moving to an alternative supplier, is therefore important.

A form of market disengagement, the causes of this inertia are commonly seen as (not exclusively): lack of knowledge and uncertainty regarding alternative service providers; apathy regarding changing provider due to entrenched habits; fear relating to the prospect of change and the perceived difficulty associated with this; the time and effort associated with changing provider, and; perceptions of the similarity of alternative service providers (i.e. “they are all as bad as each other”), there are clear opportunities for the Public Energy Company.

Furthermore, given that there are also barriers to customer participation in the energy sector, e.g. their metering set-up as highlighted above, the Public Energy Company could also be used to address such issues through direct investment, targeted tariffs (e.g. offered in conjunction with new metering installations) and wider informational programmes.

In conjunction with the ability to engage with disengaged customers directly, another element is that the offerings and wider initiatives of the Public Energy Company should be transparent and not unduly complex.

We note that the public perception of a publicly owned energy company may be a Fully Licensed supplier and not a White Label arrangement, irrespective of the iterations around it.

An example of this fact is the Mayor of London's plans for the Energy for Londoners scheme¹⁶, a feasibility study for which resulted in the decision by the Mayor to seek a White Label arrangement. While both the White Label and Fully Licensed supply options could be delivered effectively for Energy for Londoners, the former option was chosen by the Mayor of London on the grounds that it could be implemented more quickly.

This led to criticism of the decision by public interest group Switched On London¹⁷, describing the chosen option as “a half-baked white-label” based upon “pure short-termism”, and a move that “does not deliver the crucial things London needs: carbon reductions, a sure route to cutting fuel poverty, controls over tariffs, revenues for London that can be invested in renewables and the creation of jobs in our city.” Energy for Londoners has yet to go live but tendered for a potential partner supplier in May 2018¹⁸.

Due to the dynamics of the energy supply sector, as well as the potential need for strategies at both the national and local level, the delivery package of the Public Energy Company needs to be flexible and adaptable.

Here, the chosen structure would need to be capable to respond in an effective and timely manner to changes and without compromising the wider objectives of the Public Energy Company.

On the assumption that there will be some element of participation from Local Authorities in the Public Energy Company, such bodies may want differing levels of flexibility regarding this.

In addition to being flexible at a structural or overarching level, the tariff and service offerings of the Public Energy Company need to be flexible and adaptable from a customer-facing perspective.

In conjunction with the criteria immediately above, the ability of the products and services offered by the Public Energy Company to respond to changing customer needs. While not future proofing per se, the products and services must be adaptable, with examples raised in the public engagement events being the ability to expand into energy-as-a-service offerings, non-domestic supply and heat networks.

Given the profile of the initiative and the potential for cross-party and public scrutiny and public interest reporting, the Public Energy Company must provide services that adhere to the principles of quality and social equity. Here, it is assumed that the delivery option is transparent in the delivery and pursuit of wider social objectives, ensuring equality of access and participation to all stakeholders. Indeed, the “provision of social obligations” was adjudged to be among the main objectives of the Public Energy Company according to the attendees of one of the public engagement events.

¹⁶ [Energy for Londoners – Energy Supply Company Intention to Tender Decision](#)

¹⁷ [Switched on London – Mayor Shelves Fully licensed Energy Company or Short Term Political Gains](#)

¹⁸ [Energy for Londoners Tender for a Potential Partner Supplier](#)

We anticipate that there will be an ongoing public awareness and marketing campaign associated with the establishment of the Public Energy Company, and therefore it should be able to effectively communicate its mission, aims and objectives for the market and how it is achieving these via its tariffs, broader actions, and what it is doing to benefit the wider community.

4.4.8 Targeted criterion 3: Transparency and financial sustainability

Funded wholly or partly by taxpayer money, the ability of the Public Energy Company to contribute to wider social and economic development, and to operate in a clear and transparent manner is viewed as an important element – again, it is expected that this will be managed in accordance with the Scottish Public Finance Manual .

In the first instance, we note that the Public Energy Company must be capable of delivering and/or contributing to Scottish Government's policy objectives, and that it is in turn able to influence the strategic direction of the Public Energy Company. Given the repeated public statements from Scottish Government officials regarding the contribution of the Public Energy Company to economic development, this may include through direct ownership, retention of a controlling stake or wider input into the business and its growth plans.

There is a balance to be met in terms of central versus local government participation in the Public Energy Company, and we note that Local Authorities may – as part of their participation in a more decentralised model – wish to retain a similar element of control. This will enable them to dovetail policies at the national level with their own local initiatives, ensuring consistency and minimising duplication of effort and resources.

Given the goal of contributing to wider economic policy and the need to address different interest, the governance of the Public Energy Company must be as straightforward and transparent as possible. Specifically, the governance structure should not be unduly complex as this could be seen as synonymous with additional costs that could instead be targeted to the core objectives of the Public Energy Company.

The Public Energy Company must be capable of operating as a not-for profit entity – either explicitly or on a de facto basis through a commitment to reinvest profits.

However, it would also have to be a financially sustainable business to ensure that it is not in receipt of ongoing state subsidy and to avoid potential criticism regarding the use of taxpayers' money. While it is of course preferable for an energy supply company to be profitable, a supply company entity that is only marginally commercially viable in and of itself can still provide an overall net benefit to Scottish customers if it allows the Government to deliver wider social, environmental, and economic benefits.

The Public Energy Company must have the ability to Engage Local Authorities in the decision-making process. Regardless of the preferred solution adopted, it is the aim of the Project that Local Authorities have the opportunity to input in to the strategic direction of the company and to share in the benefits that it creates in their local

area, including potentially job creation, reduction in fuel poverty, and the creation of a vehicle to deliver broader energy objectives.

Local Authorities have the potential to bring a trusted 'brand' to the company as well as access to local knowledge, expertise and partnerships that can better identify and engage with local consumers and the issues that affect them. This criterion reflects the ability of each option to maximise these benefits.

The Public Energy Company approach adopted should have the ability to share set-up and ongoing costs of the entity amongst public sector investors. Set-up costs and on-going costs for the Public Energy Company could be significant. Sharing these costs amongst individual stakeholders would allow for the spreading of risk.

In line with the responsibilities of the devolved administration in Scotland, the government must ensure that its policies align with those at the wider national and European level where such areas are not reserved. The Public Energy Company therefore represents an important means by which to contribute to these at both the national and the local level.

4.4.9 Targeted criterion 4: Public policy objectives

As a positive catalyst for change and a means to alleviate fuel poverty, the operation of the Public Energy Company should also complement wider public policy objectives. While some of these could form part of the Public Energy Company's post-2023 agenda, given the medium-term aspirations of Scottish Government, they are considered here.

The ability to directly or indirectly support investment in low carbon and renewable electricity generation capacity and/or green gas – either through investment in own funds or through structured tariffs – is important, and we therefore consider that the Public Energy Company should operate in line with Scottish Government's sustainable development goals and support growth in low carbon generation capacity and other renewable energy options such as green gas¹⁹.

Given Scottish Government's policy and targets regarding low carbon generation, this should enable an integrated approach to be employed, although the funding and development of Local Authority owned generation is not specifically linked to retail market entry.

The Public Energy Company may also be used as a means by which to support social and economic cohesion. The potential to improve social and economic wellbeing, either through job creation and other employment opportunities, or through general end user engagement, was noted in the public engagement events – as was the potential for direct community participation in the Public Energy Company, potentially through an ownership or public consultation/engagement approach.

Through wider efforts at decarbonisation, the Public Energy Company may be used as a secondary means by which to improve environmental benefits such as Climate Change. While not the primary focus of the Public Energy Company, given the

¹⁹ This could be undertaken in conjunction with the Scottish National Investment Bank.

longer-term objectives of the Public Energy Company, the general ability of the outcome to reduce greenhouse gas emissions and generally improve air quality, e.g. through electrification of heat and transport is desired.

The Public Energy Company can be used to support longer-term local energy systems, tying into wider Scottish Government policies on the decentralisation of energy generation and the establishment of alternative market structures.

This recognises that as the energy market evolves into a smarter and more flexible system, fuel poverty will not only be based upon energy spend but also the ability to access technology and opportunities to engage fully with the market. As indicated above, however, these are longer-term objectives and are viewed accordingly from a scoring perspective.

4.5 Scoring of the delivery options

Each of the three delivery options have been examined against a set of mandatory and discretionary criteria, with inability to pass the former effectively negating the requirement to consider the latter. Of the three options, two are seen as passing the mandatory criteria, with the third – the Fully Licensed Supply option – failing the criterion that the Public Energy Company be operational by March 2021.

Due to the stop-go criterion of having the Public Energy Company operational by March 2021, the timescales associated with the Fully Licensed Supply option effectively render it unattainable. However, as a potential evolutionary step for Scottish Government in its energy aspirations, as well as the view that public perception of a public sector owned energy company would be synonymous with the Fully Licenced option, it is considered here for completeness.

4.5.1 Primary 1 - Fuel Poverty

Social tariffs are designed to allow suppliers to target a specific customer segment with favourable rates. In general, these are aimed at customers deemed to have a higher likelihood of vulnerability, such as customers on the supplier's priority services register²⁰, aged customers, or those in receipt of benefits.

We have seen a number of examples of these types of tariffs offered into the market. These include the Age UK tariff that was offered in conjunction with E.ON. Another, and potentially more significant, example is the tariff offered by Spark to social housing tenants. At launch, this was one of the cheapest PPM tariffs on the market and also included a small credit on the meter (£5 per fuel) to prevent debt accumulating while the property was void.

This indicates the type of tariff that could be potentially offered by the Public Energy Company to help support vulnerable residents.

Under Fully Licensed Supply, the supplier has full control over the tariff prices offered. While it is the case under both Fully Licensed and White Label options that tariffs will have to change in response to cost movements, a Fully Licensed supplier

²⁰ The Priority Services Register is a database run by suppliers that holds information on vulnerable customers.

has more opportunity on when and how to pass through any changes (e.g. by tariff type, region, pricing structure (standing charge and unit charge), payment method, fixed or variable etc.).

Therefore, in theory this route would give the Public Energy Company full flexibility to offer social tariffs as desired. However, the fundamental costs of supply faced by the licensed supplier will be a major driver of its ability to offer social tariffs.

Therefore, while this route offers greater flexibility it still faces limitations on the level and breadth of social discount that could be offered. This is particularly true for any new entrant where relatively low customer numbers/supply volumes mean that there is a fine balance between receiving sufficient revenue from customers to cover set-up and ongoing operational costs.

White Label Supply could in theory allow the delivery of a social tariff if an agreement is reached with the partner supplier. Ebico's previous long-standing arrangement with SSE was the best example of this in the market, as the tariff structure was radically different from those offered by the parent supplier. However, this requires the cooperation of the partner supplier to deliver the tariff.

This may present a barrier to delivery as it is reliant on the parent supplier's systems being capable of offering the more bespoke tariff and the agreement of financial terms. This is likely to be the larger sticking point as we understand that many of these tariffs are set at the cost of supply, or potentially subsidised.

If this was the case it would likely require the sacrifice of value elsewhere by the Public Energy Company and it is uncertain if a partner supplier would be willing to take this risk and loss of value. We expect that the Local Authority-backed suppliers such as Robin Hood Energy and Bristol Energy will be more willing to offer this type of tariff than other commercially-driven suppliers due to their social aims, although this is not a certainty (noting Norwich City Council's proposed tariffs with Engie under its White Label supply agreement).

However, from our conversations with these suppliers, we understand that the majority of the tariff price is determined by the supplier's core costs of supply and the only major section the White Label partner has control over is the income the White Label supplier achieves for the customers' contracts. Therefore, there is likely to be limited flexibility to offer significant discounts when compared to the partner supplier's own tariffs under this route to market.

Additionally, beyond the direct saving achieved from customers switching to cheaper Public Energy Company tariffs, the Public Energy Company is also forecast to help address fuel poverty by increasing broader customer engagement with the energy market within Scotland. This engagement would be driven by the media coverage and increase in consumer awareness of the competitive energy market, their ability to switch, and the potential savings associated with doing so. While this engagement may not result in the customers switching to the Public Energy Company, it still has the potential to help to address fuel poverty by increasing engagement as a whole, and therefore the number of customers switching to a new, alternative tariff – which is assumed to be cheaper than their current tariff, particularly if they have previously been disengaged and on an SVT.

We would recommend that if the Public Energy Company were to proceed with this route to market that it looks to include the potential to offer social tariffs as part of its negotiations with the partner supplier and ensures that it retains the potential to do so.

Table 14 – Fuel poverty score

Delivery Option	Score (out of 10, ascending numerical order)
Option 1: Fully Licensed Supply	8
Option 2: White Label Supply	7
Option 3: Do Nothing	1

4.5.2 Primary 2 – Greater consumer choice

Addressing customer inertia

One of the main expected benefits from public authorities entering the market is their ability to engage with historically disengaged end users, and to reach out to customers beyond the “typical” switcher. It is also likely that the authority entering the market will see an increased focus on energy from local media outlets.

This is expected to lead to a more general increase in awareness of, and engagement by, local residents with the market - increasing switching rates, even if not to the Public Energy Company.

This is one of the broader benefits of the Public Energy Company entering the market, as it means that it does not need to offer a market leading tariff to save consumers money but can help drive wider customer engagement through with the market.

Table 15 – Addressing customer inertia score

Delivery Option	Score (out of 10, ascending numerical order)
Option 1: Fully Licensed Supply	7
Option 2: White Label Supply	7
Option 3: Do Nothing	1

Complexity of offering or wider initiative for consumers

Conceptually, Fully Licensed Supply is more likely to be what the general public would perceive as a “publicly-owned not-for-profit energy company”. This is seen as a straightforward and transparent concept for potential customers.

Although a White Label Supply may therefore be viewed as a “diluted” alternative which, while it has the potential to tap into many of the same elements as its Fully Licensed counterpart, may not carry the same customer perception.

However, depending upon the ownership and governance structure chosen, both structures may permit stakeholders to focus policy at the local level. This allows for more in-depth communication, but also adds an element of complexity, with a risk of this increasing as the number of stakeholders increases.

Such issues would therefore need to be considered when determining the ownership and governance arrangements for the Public Energy Company.

Table 16 – Complexity of offering or wider initiative for consumers score

Delivery Option	Score (out of 10, ascending numerical order)
Option 1: Fully Licensed Supply	7
Option 2: White Label Supply	7
Option 3: Do Nothing	1

Flexibility and adaptability of delivery package

Full control of the Public Energy Company under a Fully Licensed Supply model would enable the greatest level of flexibility to respond to changes in the energy sector and cost drivers.

The White Label Supply option is more reliant upon the relationship with the partner supplier and the extent to which the ownership and management structure allow for rapid decision making.

Table 17 – Flexibility and adaptability of delivery package score

Delivery Option	Score (out of 10, ascending numerical order)
Option 1: Fully Licensed Supply	8
Option 2: White Label Supply	7
Option 3: Do Nothing	1

Flexibility and adaptability of product and service offerings

As stated above, under Fully Licensed Supply, the supplier has full control over the tariffs that it is able to offer, as well as having more flexibility on when and how to pass on changes in costs. This is reflected in the score the Public Energy Company has been assigned for this criterion.

White Label Supply could permit suitably flexibility in tariffs in the presence of such an agreement with the partner supplier. Depending upon the ownership and governance structure, this could be regionalised, with such a prospect negotiated as part of the tender process for the partner supplier.

Table 18 – Flexibility and adaptability of product and service offerings

Delivery Option	Score (out of 10, ascending numerical order)
Option 1: Fully Licensed Supply	8
Option 2: White Label Supply	6
Option 3: Do Nothing	1

Quality and fairness of service

Given the assumed high-profile status of the Public Energy Company, we assume that all delivery options will be scored largely equally. It is anticipated that an initiative such as the Public Energy Company will be subject to ongoing greater scrutiny from MSPs, media and the general public – given the use of public funds.

Table 19 – Quality and fairness of service score

Delivery Option	Score (out of 10, ascending numerical order)
Option 1: Fully Licensed Supply	7
Option 2: White Label Supply	7
Option 3: Do Nothing	1

4.5.3 Primary 3 – Economic development

Oversight and control

In the case of Fully Licensed Supply, it is our assumption that the Public Energy Company entity would be set up by the Public Sector with an objective of ensuring transparency and accountability for residents and Scottish taxpayers.

The commercial structure of Public Energy Company is therefore critical to allow it to operate commercially while ensuring governance arrangements are sufficiently flexible to allow interested parties to be meaningfully involved in delivering the Public Energy Company's core objectives. Here, the Public Energy Company would be established as a separate company or special purpose vehicle (SPV) that is owned by the Public Sector investors.

As this model requires the Public Energy Company to undertake numerous commercial activities, including trading and procuring the services of several third parties, the governance arrangements would necessarily be more complex and potentially less flexible. This is to ensure that the Public Energy Company has sufficient flexibility to be managed by its executive to undertake necessary day-to-day activities associated with running a trading commercial entity, while retaining long-term strategic setting with the owners.

The White Label Supply option would be a partnership arrangement with a licensed energy supply company. The Public Energy Company could be constituted as a bilateral contract between a Fully Licensed supply partner and the public sector owners. The length of these arrangements would be decided as part of the contract negotiations, but typically these are between three to five years. Recently announced White Label partnerships have fallen within this range, for example, Norwich City Council was a three-year agreement, Hackney Council was four years and Liverpool City Council five years.

In case of central and local government combined governance, the Public Energy Company could be established as an SPV controlled by the Public Sector partners and with contractual and governance arrangements defined in a way that would allow other interested parties to share in the costs, risks and benefits of the Public Energy Company's activities.

As the White Label model is significantly less onerous than Fully Licensed supply, we believe the establishment of governance arrangements to be more straightforward. However, as a minimum, the entity would have to be able to make and receive payments, be staffed, and have sufficient operational flexibility to respond to White Label contractual changes—particularly tariff changes.

Table 20 – Oversight and control score

Delivery Option	Score (out of 10, ascending numerical order)
Option 1: Fully Licensed Supply	7
Option 2: White Label Supply	7
Option 3: Do Nothing	1

Not for profit (explicit or de facto by commitment to re-invest)

As stated above, under Fully Licensed Supply, the supplier has full control over its operational activities and the use of revenues under “profit for a purpose”. While not explicitly limited or otherwise restricted under White Label Supply, the absence of this explicit control sees this scored lower.

Table 21 – ‘Not-for-profit’ score

Delivery Option	Score (out of 10, ascending numerical order)
Option 1: Fully Licensed Supply	8
Option 2: White Label Supply	8
Option 3: Do Nothing	1

Set-up costs

As a result of the minimal regulatory obligations under the White Label Supply model and handling of the majority of tasks by the partner supplier, the primary set-up costs for White Label supply concern negotiating and agreeing terms with the potential fully licensed supplier partners. The main ongoing costs will be centred around customer acquisition from the staff involved and direct marketing costs.

However, setting up the Public Energy Company as a Fully Licensed supplier would be more expensive due to the workforce and IT systems needed, which somewhat balances out the greater revenue it can accrue. It is also more complicated, requiring specialist skills to establish.

Table 22 – Set-up costs score

Delivery Option	Score (out of 10, ascending numerical order)
Option 1: Fully Licensed Supply	2
Option 2: White Label Supply	6
Option 3: Do Nothing	10

Complexity of governance for Scottish Government (simplicity, clarity and transparency)

See “Oversight and control” for relevant information. Depending upon the ownership and governance arrangements, greater local ownership through White Label Supply assumes greater control and representation at the decentralised level, which will free up resources for Scottish Government but require increased representation by Local Authorities.

Table 23 – Complexity of governance score

Delivery Option	Score (out of 10, ascending numerical order)
Option 1: Fully Licensed Supply	6
Option 2: White Label Supply	6
Option 3: Do Nothing	1

Ability of the entity to engage Local Authorities in the decision-making process

The Scottish Government has indicated that they are keen for Local Authorities (and other public sector agencies such as education, healthcare and blue light services) to be engaged in the establishment and operation of the Public Energy Company, with such a prospect also being noted in the public engagement events.

To that end, the governance structure should be of such a nature that key public sector stakeholders invested in the success of the Public Energy Company are able to inform its decision-making process and wider strategic focus.

As with FLS - depending upon the ownership and governance arrangements - further local ownership and representation incorporating local authorities or other stakeholder groups may be possible through White Label Supply, but this needs to be balanced in terms of the resultant complexity of company structure and decision making.

Table 24 – Ability to engage Local Authorities score

Delivery Option	Score (out of 10, ascending numerical order)
Option 1: Fully Licensed Supply	3
Option 2: White Label Supply	7
Option 3: Do Nothing	1

Ability to share set-up and ongoing costs of the entity amongst Scottish Government and Local Authorities

The set up and on-going costs for the Public Energy Company could be significant. Therefore, the sharing of these costs amongst individual stakeholders allows for the spreading of risk. Under the Fully Licensed Supply option, these costs are centralised within Scottish Government itself – an outcome which is reflected in the scoring.

While the means by which funding is assigned by each individual agency will be confirmed, e.g. through allocated areas of responsibility, shareholder agreements, or individual budget setting processes, the Public Energy Company’s structure should permit some element of co-funding, potentially commensurate with governance and control responsibilities.

Table 25 – Ability to share set-up and ongoing costs score

Delivery Option	Score (out of 10, ascending numerical order)
Option 1: Fully Licensed Supply	5
Option 2: White Label Supply	5
Option 3: Do Nothing	1

4.5.4 Public policy objectives

Sustainability and ability to support growth in low carbon generation capacity

As a Fully Licensed Supplier, the Public Energy Company would have full control over its contracting arrangements. Therefore, it would have the full flexibility to sign offtake contracts as desired. Fully Licensed supply is also expected to generate more significant revenues in the long term which could provide greater opportunity for reinvestment.

Under typical White Label Supply, the Fully Licensed partner is normally the party responsible for the wholesale trading arrangements. Despite this, our experience of White Label providers in the market indicates that they may be amenable to allowing

the Public Energy Company to take on greater responsibility for trading or to fold in specific generation assets it owns.

However, we would expect that these would be subject to the Public Energy Company taking on increased responsibility and likely lodging collateral with their partner to cover their trading.

Table 26 – Sustainability and ability to support growth score

Delivery Option	Score (out of 10, ascending numerical order)
Option 1: Fully Licensed Supply	7
Option 2: White Label Supply	7
Option 3: Do Nothing	1

Supporting social and economic cohesion

On the assumption of centralised control and funding, the Fully Licensed Supply option will enable greater coordination with wider Scottish Government policy.

Again, an ownership and governance that enables greater Local Authority involvement in the White Label company may permit a more focused targeting of initiatives to those areas and resident groups in greatest need.

Table 27 – Supporting social and economic cohesion score

Delivery Option	Score (out of 10, ascending numerical order)
Option 1: Fully Licensed Supply	7
Option 2: White Label Supply	7
Option 3: Do Nothing	1

Climate change mitigation and wider air quality issues

As with supporting own generation, a supply entity could allow the Public Energy Company to help support local low carbon generators through contracting arrangements. Again, this could be long term offtake agreements with developing generators to help ensure Project completion. A White Label supply option could also seek to meet this objective, through careful selection of and negotiation with the partner supplier to ensure aims are met. As such, although the mechanisms differ, it is deemed that the capacity to support this aim could be met under both structures

Table 28 – Climate change mitigation and wider air quality issues score

Delivery Option	Score (out of 10, ascending numerical order)
Option 1: Fully Licensed Supply	7
Option 2: White Label Supply	7
Option 3: Do Nothing	1

Ability to support longer-term decentralised energy systems

Municipal energy companies have the potential to facilitate investment in local generation (including cogeneration of heat and power and the emerging battery storage market) by offering long-term contracts to purchase the output from local assets; this is a key consideration for all power projects – the need to find a buyer for their output.

Many Local Authorities are considering greater participation in the energy market to facilitate the delivery of wider sustainability programmes. These variously include regeneration areas with “energy centres” that supply heat and power to residents, the public estate and commercial premises.

While Fully Licensed Supply assumes greater control, a decentralised White Label Supply option would enable a more targeted approach to support.

Table 29 – Ability to support longer-term decentralised energy systems score

Delivery Option	Score (out of 10, ascending numerical order)
Option 1: Fully Licensed Supply	7
Option 2: White Label Supply	7
Option 3: Do Nothing	1

The resultant outcome of this assessment is presented in the table on the following page.

Table 30 - Assessment of delivery options for the Public Energy Company

Option	Weighting %	Option 1: Fully Licensed Supply		Option 2: White Label Supply		Option 3: Counterfactual (Do Nothing)	
Mandatory pass/fail questions							
Can be fully implemented and be operational no later than March 2021	N/A	No		Yes		Yes	
Can be implemented in compliance with State aid legislation	N/A	Yes		Yes		Yes	
Primary 1: Fuel Poverty		Score	Weighted Score	Score	Weighted Score	Score	Weighted Score
Fuel poverty	22.50%	8	1.80	7	1.58	1	0.23
Primary 2: Greater Consumer Choice		Score	Weighted Score	Score	Weighted Score	Score	Weighted Score
Ability to address customer inertia	6.25%	7	0.44	7	0.44	1	0.06
Complexity of offering or wider initiative for consumers	4.50%	7	0.32	7	0.32	1	0.05
Flexibility and adaptability of delivery package	4.50%	8	0.36	7	0.32	1	0.05

Flexibility and adaptability of product and service offerings	4.50%	8	0.36	6	0.27	1	0.05
Quality and fairness of service	8.50%	7	0.60	7	0.60	1	0.09
Primary 3: Economic Development		Score	Weighted Score	Score	Weighted Score	Score	Weighted Score
Oversight and control	6.25%	7	0.44	7	0.44	1	0.06
Not for profit (explicit or de facto by commitment to re-invest)	6.25%	8	0.50	8	0.50	1	0.06
Set-up costs	6.50%	2	0.13	6	0.39	10	0.65
Complexity of governance (simplicity, clarity and transparency)	5.00%	6	0.30	6	0.30	1	0.05
Ability of the entity to engage Local Authorities in the decision making process	5.25%	3	0.16	7	0.37	1	0.05
Ability to share set-up and ongoing costs of the entity amongst investors	3.75%	5	0.19	5	0.19	1	0.04
Primary 4: Broader Scottish Government objectives		Score	Weighted Score	Score	Weighted Score	Score	Weighted Score
Sustainability and ability to support growth in low carbon generation capability	5.00%	7	0.35	7	0.35	1	0.05

Supporting social and economic cohesion	3.75%	7	0.26	7	0.26	1	0.04
Climate change mitigation and wider aid quality issues	3.75%	7	0.26	7	0.26	1	0.04
Ability to support longer-term decentralised energy systems	3.75%	7	0.26	7	0.26	1	0.04
Total	100.00%		N/A		6.83		1.59

Conclusions

The purpose of this section has been to examine the objectives of Scottish Government in its efforts to establish a Public Energy Company and – building upon the SOC – assess a number of commercially and practically viable alternatives. In doing so, we note that main objectives of Scottish Government are:

- Addressing fuel poverty;
- Providing greater choice to consumers;
- Contributing to economic development; and
- Contributing to broader Scottish Government policy ambitions.

Based upon contributions from attendees at the public engagement events for the Public Energy Company, the main alternatives that emerged were White Label Supply (WLS) and Fully Licensed Supply (FLS).

Based upon the scoring of the proposed delivery options presented in Section 4.5, the White Label Supply approach emerges as the preferred option, and while the Fully Licensed Supply approach is also highly scored, it cannot be achieved in the required timescales for the implementation of the Public Energy Company.

Therefore, on the assumption that Scottish Government is not able to amend timescales for implementation of the Public Energy Company, the preferred delivery option is White Label Supply.

In pursuing a WLS option, the Public Sector investors would be following an approach already utilised by over a dozen Local Authorities across the GB energy market, most notably Yorkshire's White Rose Energy and Liverpool's LECCy (both White Label Suppliers established with Robin Hood Energy as a partner).

Should it be decided to undertake the option of establishing a Public Energy Company as a White Label Supplier, it would have to determine the ownership structure and governance of the company, which would include Public Sector ownership as a means by which to promote greater engagement at the local level and more focused targeting of any specific policy initiatives.

It should be noted that, in the long run, White Label and Fully Licensed supply are not mutually exclusive and that Scottish Government may – based upon its experiences of undertaking a WLS operation – look in time to develop a successor in the form of a Fully Licensed operation.

However, based upon the scoring results, the following sections therefore detail the risks and high-level economic model associated with the preferred delivery option of White Label supply.

4.6 Risks and SWOT Analysis

The scoring of the proposed delivery options yielded the White Label Supply (WLS) option as the preferred outcome. This section therefore details SWOT analysis

associated with this method of establishing the Public Energy Company. The Risk Register can be found at Appendix A.

SWOT analysis

Given the points raised in the preceding section, the table below presents a SWOT analysis of the preferred delivery model.

Table 31 - SWOT analysis for White Label supply

Strengths	Weaknesses
<ul style="list-style-type: none"> • Lower overall cost compared to Fully Licensed Supply option • Meets Scottish Government’s stated policy commitment within timescales • Ability to tap into wider central-local government relationships • Source of (limited) revenue • Low administrative burden • Compliance risks borne by partner supplier • Market and trading risks borne by partner supplier • Rapid market entry • Public-backed White Label is a proven approach • Lower loan/ capital cost risk 	<ul style="list-style-type: none"> • Lower levels of revenue accrued compared to Fully Licensed Supply option • Customers “belong” to the partner supplier, meaning they may be lost if the Public Energy Company’s contract with the partner ends, and ensuring the retention of customers may result in the relinquishing of value by the Public Energy Company • Limited scope for capturing and reinvesting local energy spend under retention payments • Limited opportunity for incorporating longer-term objectives, e.g. self-generation, compared to Fully Licensed Supply • Low potential for innovation in the face of industry/market change • Exposure to reputational risk from actions of partner supplier's actions • Uncertain process at end of contract with partner supplier-e.g. no certainty of renewal, alternative partner provider
Opportunities	Threats

-
- Provision of local tariff/contracts to help local residents/businesses with more suitable products where a "sympathetic" licensed supplier partner can provide reasonable terms on an ongoing basis
 - Potential scale of Scottish market likely to be attractive partnership option
 - Chance to deliver smart meters to customers - particularly prepayment customers - with support of partner
 - Chance to engage customers around energy efficiency and promote local energy efficiency schemes
 - Use White Label to build up brand and experience with a view to moving to wider energy-as-a-service offerings and potentially to a Fully Licensed Supply model
 - Potential to negotiate PPAs to support local generation
 - Potential to secure ECO and WHD support from participating third party supplier
 - Partner supplier cannot be found/fails to deliver under contract/ceases trading
 - Partner supplier breaches compliance requirements, exposing the Public Energy Company to reputational or financial risk
 - Long term viability of the model in question, as it relies on the continuing appetite of the partner supplier after initial contract period
 - Local Authorities may cease participation in the Public Energy Company and establish their own supply entities
 - Competition from incumbents, particularly other Local Authority-backed suppliers, e.g. Robin Hood Energy, Bristol Energy
 - Partner supplier not being a mandatory WHD/ECO participant and does not wish to be so voluntarily
 - Customer uptake below expectation, resulting in exposure to financial/reputational risk
 - Regulatory and policy framework changes that puts model at risk
 - Poor execution of implementation plan
-

Source: Cornwall Insight analysis

4.7 Economic modelling of the preferred delivery option

Based upon the conclusions of Section 4.5, the scoring of the proposed delivery options yielded the WLS option as the preferred outcome. Not only was the Fully Licensed Supply Option not deliverable in the desired timeframes for Scottish Government, it also carries significantly greater risk and investment of time and resources than the WLS option, rendering it, despite the similarity of the qualitative scoring, the less desirable option to be pursued. This section therefore details the high-level economic model associated with this method of establishing the Public Energy Company.

4.7.5 Approach to Economic Model

The Economic Model is intended to provide an indicative overview of the potential high-level revenue and costs for the Public Energy Company. This is to support and inform the comprehensive view provided by the detailed Commercial Model.

The Economic Model has been populated with indicative values based upon a combination of Cornwall Insight's understanding of the terms achieved by – and experiences of – other Local Authority White Label Suppliers, and also based upon our understanding of the energy supply market.

These figures are intended to provide a high-level representative view of the likely situation for the Public Energy Company. They should not be relied upon in isolation given the rapid changes currently ongoing in the energy market, the highly bespoke nature of White Label negotiations, the unique position of Scottish Government in its pursuit of a national (rather than regional or municipal) White Label offering to underpin the Public Energy Company, and the remaining flexibility in what WLS model will ultimately be progressed.

In the following sections and at Appendix F we have detailed our reasoning behind the initial inputs to the model.

All cash amounts are presented in real terms using Year One as a base year.

4.7.6 Scenarios

We have provided three different scenarios for the economic model:

- **Core.** This case is based upon our understanding of the market and the current operating conditions. This should be taken as the 'core assumption'. Under this scenario the Public Energy Company is profitable by Year Two under the Acquisition approach and Year Five under the Retention approach (under the Economic Modelling assumptions – this may change following the application of commercial assumptions in the Financial Modelling)
- **Optimistic.** This scenario represents a 'best case' scenario for the Public Energy Company, where set-up and operating costs are reduced to the possible minimum and customer acquisition rates are above the expected level. In this scenario, the Public Energy Company is profitable by Year Three under the Retention Model and Year Two under the Acquisition Model and net

profitable by Year Three (under the Economic Modelling assumptions – this may change following the application of commercial assumptions in the Financial Modelling)

- **Pessimistic.** This scenario is intended to represent a ‘worst case’ scenario where the Public Energy Company faces higher costs to set-up and operate as an ongoing concern and is less successful in attracting customers than anticipated. Under this scenario the Public Energy Company does not break even by the end of the ten-year modelling horizon under the Retention Model or the Acquisition Model (under the Economic Modelling assumptions – this may change following the application of commercial assumptions in the Financial Modelling).

4.7.7 Consumer gain

In examining the potential *indicative* consumer gain associated with the establishment of the Public Energy Company, we have employed tariff data as of 1 January 2019 on the following basis.

We assume three tariff offerings for the Public Energy Company:

- Scottish Value, i.e. the standard “White Label” tariff offering for the majority of the customer base;
- Scottish Economy, i.e. the means-tested tariff offering for those in fuel poverty; and
- Scottish Premium, i.e. the socially minded tariff that sees customers pay a higher rate to contribute to a fund to support wider measures to alleviate fuel poverty.

The following analysis is based upon the use of the Scottish Value tariff as a counterfactual against which the prevailing situation is assessed.

Prevailing view

As at 1 January 2019, Cornwall Insight analysis indicates that the standard variable tariff (SVT) being paid by those dual fuel domestic accounts²¹ in the Scottish Hydro (SSE) region (North Scotland) equates to an annual energy spend of £1,154. The corresponding figure for accounts in the Scottish Power region (South Scotland) is £1,125 per annum.

- These figures are used as a proxy for those customers that are disengaged from the energy market and still with their regional incumbent supplier

In examining customer information for both regions, Cornwall Insight analysis indicates that SSE has approximately 500,000 customer accounts in its incumbent region, while Scottish Power has approximately 950,000 customer accounts in its incumbent region.

²¹ Paperless direct debit

According to the most recent information published by Ofgem²², approximately 70% of SSE's customers are on an SVT, with approximately 38% of Scottish Power's customers on their SVT.

We therefore assume that 70% of the 500,000 SSE accounts in their incumbent region are on an SVT (i.e. 350,000), with 38% of the 950,000 Scottish Power accounts (361,000 accounts) being the corresponding figure.

- This therefore equates to a weighted average annual energy spend of **£1,139** for the Scottish market as a whole

Counterfactual

As an indicator of the Scottish Economy tariff, we have used the lowest cost tariff in each of the two regions as offered by Robin Hood Energy. This company has been used as a basis for the tariffs because:

- It is a high-profile, socially motivated and publicly-owned energy company;
- Given the company's presence as the White Label provider to Local Authorities across the country, we anticipate that it would be interested in becoming Scottish Government's White Label partner and that it is a suitable benchmark for a Public Energy Company White Label Supplier for Scotland; and
- Robin Hood has a wide variety of white label tariffs active in the market, which are all priced at, or cheaper than the company's own-branded (i.e. non-White Label) tariff prices

NB. We note that this is not the lowest cost tariff available on the market, and therefore this represents an indicative assessment of the gains that could be achieved by customers switching to the Public Energy Company.

For the purpose of this analysis, the counterfactual is based upon Robin Hood Energy's lowest cost tariff as offered in the two regions, this being the company's "Green Fixed" product, which was quoted at £1,100 per annum and £1,068 per annum in the Scottish Hydro and Scottish Power regions respectively.

- Using the assumed customer numbers indicated above, this equates to a weighted average for the disengaged Scottish market as a whole of £1,084 per annum.

This therefore implies a minimum indicative differential of £55 per annum that would be achieved as a benefit by customers that switch to the Public Energy Company.

This information is summarised in below:

²² [Ofgem – Standard Variable Tariff Indicators – Previous Updates](#)

Table 32 - Indicative consumer benefit associated with the Public Energy Company (tariff data as at 1 January 2019)

	Incumbent region: Scottish Hydro (SSE)	Incumbent region: Scottish Power
SSE SVT (implied £ per annum spend)	£1,154	£1,125
Scottish Power SVT (implied £ per annum spend)	£1,155	£1,125
Total customer accounts with incumbent in region (approx.)	500,000	950,000
Estimated percentage of TOTAL customer base on SVT	70%	38%
Implied supplier customer accounts on SVT in incumbent region, i.e. assumed “disengaged” Scottish customer base	350,000	361,000
Weighted average tariff for “disengaged” Scottish customer base (implied £ per annum spend)	£1,139	
Robin Hood Energy Green Fixed (implied £ per annum spend)	£1,100	£1,068
Implied weighted average tariff for potential Scottish customer base (implied £ per annum spend)	£1,084	
Indicative consumer benefit with switching from SVT to Public Energy Company (implied £ per annum spend)	£55	
Core case customer numbers by end of Year Five	220,000	
Implied cumulative benefit Years One to Five inclusive	£12.1mn	

(real terms using Year One as a base year)	
--	--

Source: Cornwall Insight analysis, Ofgem, company statements

Based upon the assumed customer growth in the Core case of the economic model (details of which are provided in Table 40), by the end of Year Five, the Public Energy Company will have approximately 220,000 customers – representing a cumulative indicative benefit of £12.1mn over the first five years of operation²³.

However, on the assumption that each customer that becomes part of the Public Energy Company’s portfolio would continue to receive the benefit of being on a tariff lower than their (former) incumbent supplier’s default, this figure represents the **minimum initial achievable customer benefit** in the absence of the anticipated enduring benefits.

As stated above, we assume that the Public Energy Company is not the lowest cost tariff on the market. However, given that the operation of the Public Energy Company will lead to greater engagement in the energy market, some customers may see a greater initial benefit from changing supplier. In addition, a disengaged customer may make an initial switch to the Public Energy Company and then make further switches to achieve a greater cumulative benefit.

Consumer group Which? state that the benefits associated with switching supplier range from £163 per annum to £412 per annum²⁴, while Ofgem indicate an average figure of £200 from switching supplier²⁵ - this being the figure cited by Islington Borough Council in its establishment of its White Label, Angelic Energy²⁶.

Utilising the Ofgem figure of a £200 saving from an initial switch, if the Public Energy Company were able to achieve this initial saving for all of the customers that switch to it, this would imply a total initial achievable customer benefit of £44mn.

As such, the figure of £12.1mn represents a potential understatement of the consumer benefits associated with the tariffs of the Public Energy Company.

In addition, it does not consider the redistributive effects associated with the Scottish Economy and Scottish Premium tariffs. The size of the benefit under these tariffs will depend of the uptake of the two tariffs, and so cannot be directly quantified at this time. These tariffs, although notionally yielding no **net** benefit - would be expected to yield longer term social benefits and externalities.

²³ Note that this is before churn. However, we assume that each customer that joins the Public Energy Company achieves this benefit once.

²⁴ [Which – Top 5 Cheapest Energy Deals for February 2019](#)

²⁵ [BBC News – Energy Prices to Increase for Millions as Ofgem Raises Price Cap](#)

²⁶ [Islington Council – Angel Energy Islington’s White Label Energy Supplier](#)

4.8 Conclusions

The Scottish Government's March 2018 Strategic Outline Case²⁷ presented a shortlist of four delivery options for the Public Energy Company – the deadline for the establishment of which is the end of the current Parliament in 2021.

The purpose of this **Economic Case** was to revisit the shortlist in light of Cornwall Insight's research and market experience and the outcome of the public engagement events undertaken regarding the Public Energy Company - building upon the content of the Strategic Case. These events yielded three potential delivery options as follows:

- Option 1: Fully Licensed Supply
 - A Public Energy Company would be established as a licenced gas and electricity supplier with full responsibility for complying with the associated industry codes and regulatory requirements. Here, the owners of the Public Energy Company would have full control over the type and structure of tariffs it offers.
- Option 2: White Label Supply
 - This would involve contracting with an existing licensed supplier, enabling the Public Sector investors to provide branded and tailored energy tariffs (electricity, gas, and dual fuel) to residential customers. The Public Energy Company would be established by partnering with an existing licensed supplier, thereby enabling the Public Sector owners to provide tailored and branded energy tariffs (electricity, gas, and dual fuel) to residential customers in its area.
- Option 3: Counterfactual (Do Nothing)
 - The Scottish Government would continue with existing policies and would not take any supplemental effort to establish energy supply activity in Scotland.

These delivery options were assessed against the main objectives of the Scottish Government in establishing the Public Energy Company, these being

- Addressing fuel poverty
 - The ability to mitigate or reduce fuel poverty among the population of Scotland. This can include, but may not be limited to, areas such as the ability to offer targeted or cross-subsidised tariffs, funding for initiatives to improve energy efficiency, interaction with housing policy, etc.
- Providing greater choice to consumers
 - This includes a number of aspects but is synonymous with encouraging customers that have not previously sought to engage with the energy market to do so - notably through improved switching and the provision

²⁷ [Scottish Government – Public Energy Company Strategic Outline Case](#)

of information and services to facilitate this.

- Contributing to economic development
 - The chosen delivery option must ensure that the Scottish Government's policy objectives are delivered effectively and that it is able to influence the strategic direction of the Public Energy Company to facilitate wider economic growth
- Contributing to broader Scottish Government policy ambitions.
 - The ability to directly or indirectly support investment in low carbon and renewable electricity generation capacity and/or green gas, either through investment or through structured tariffs, as well as aiding in areas such as social cohesion.

The pursuit of each of these objectives was scored and assigned a weighting, reflecting the importance of each of them in the overall process. Based upon this assessment, the White Label Supply approach emerges as the preferred option, and while the Fully Licensed Supply approach is also highly scored, it cannot be achieved in the required timescales for the implementation of the Public Energy Company by 2021.

Therefore, on the assumption that the Scottish Government is not willing to amend its timescales for implementation of the Public Energy Company, and the significant cost differential between the two options, as well as the significant difference in exposure to risk, the preferred delivery option is White Label Supply.

Should the option of becoming a White Label supplier be chosen, the ownership structure and governance of the company would need to be determined, which may include local authorities as a means by which to promote greater engagement at the local level and more focused targeting of any specific policy initiatives.

During the set-up phase, industry and legal specialists will be required to assist with negotiating contracts and services, translating a business plan into a Target Operating Model, developing strategies for trading and pricing, marketing and public engagement and wider social initiatives.

The commercial and reputational risks and their mitigation would need to be a core element of the creation of the Public Energy Company, and we therefore recommend that each stage of the company's development has a Risk Register to ensure that these are monitored and addressed accordingly.

Based on the counterfactual against the lowest cost tariff in each of the two regions as offered by Robin Hood Energy, under the Core case scenario a cumulative indicative benefit of £12.4m (based on the Economic modelling) over the first five years of operation for the modelled 220,000 customers is expected. This is based on the difference between Robin Hood Energy's tariff as the proxy for the Public Energy Company's offering and the incumbent default tariffs offered in the Scottish region.

In pursuing a WLS option, Public Sector investors would be following an approach already utilised by over a dozen local authorities across the GB energy market, most notably Yorkshire's White Rose Energy and Liverpool's LECCy (both White Label suppliers established with Robin Hood Energy as a partner).

It should be noted that, in the long run, White Label and Fully Licensed supply are not mutually exclusive and that the Public Sector investors may – based upon its experiences of undertaking a WLS operation – look in time to develop a successor in the form of a fully licensed operation.

5 Commercial Case

5.1 Introduction

The commercial options appraisal in this section assesses the preferred delivery option and the corporate, legal and commercial structure of the Public Energy Company. The objective of the commercial options appraisal is to determine what the level and nature of involvement of Public Sector investors and what vehicle/strategy should be pursued in order to achieve the preferred solution. In addition, legal considerations for each option are also discussed. As the Project progresses, full legal advice needs to be sought and a thorough legal review of the OBC will be performed.

The Commercial options appraisal process took place over the period December 2018 to March 2019.

Based on the work conducted through the SOC, the Strategic Case and the Economic Case, the preferred approach to be delivered is:

Table 33 - Preferred option

White Label Model (with option for Joint Ownership)

The Public Energy Company is established by interested Public Sector parties, having chosen a suitable White Label partner in line with criteria determined as part of a formal tender process. Management of the resultant entity is undertaken collectively by the participants.

In this role, Scottish Government would serve in an arms-length capacity through market support and other assistance to establish common cross-boundary rules.

5.2 Required Services

As previously discussed, the Project has the following key objectives:

- To deliver a Public Energy Company to a timetable deliverable by March 2021
- To be sufficiently financially robust to be self-financing in the longer term
- Assist in the delivery of competitively priced energy to help alleviate fuel poverty in Scotland
- Actively engage with disenfranchised customers, particularly those suffering from fuel poverty
- To be presented in a form that allows for Local Authorities to 'opt in' as equity owners
- A Commercial structure designed to allow for the expansion of business objectives beyond the initial scope of the Public Energy Company

5.3 Roles and responsibilities

There are a number of key stakeholders involved in, and impacted by, the creation of a Public Energy Company in Scotland. The Public Sector investors who opt to be rigorously engaged in the activities of the entity will be responsible for the governance and running of the entity. The chosen commercial partner, providing energy to the Public Energy Company under a White Label arrangement is another key stakeholder, as are the consumers themselves, who the Public Energy Company will hope to attract.

- Potential sponsors:
 - o Scottish Government
 - o Engaged Local Authorities
- Customers:
 - o Scottish domestic customers in fuel poverty
 - o Other Scottish domestic customers
 - o Other UK based customers
- Energy suppliers:
 - o Selected White-Label Energy supplier

5.4 Possible commercial structures

The First Minister announced the intention to establish a publicly owned energy company (Public Energy Company) on 10 October 2017. The commitment was made to establish the Public Energy Company by the end of the current parliament (March 2021), therefore the preferred delivery option and chosen commercial structure is intended to be achievable in this timeframe. As noted above, the initial key objective of the Public Energy Company is to help reduce fuel poverty in Scotland by offering competitively priced energy (gas and electricity) and encouraging disengaged customers to switch suppliers in order to secure a better deal than their current provider. The focus will be on domestic customers in Scotland.

It is anticipated that the entity will be set up as a not-for-profit entity, with surpluses generated from business activities being reinvested to provide support to projects aiming to help alleviate fuel poverty in Scotland. Although many of the day to day functions required by the Public Energy Company in delivering energy to customers will be met by the chosen third party White Label Supplier, the Public Energy Company will be required to deliver functions including negotiation and ongoing management of the White Label supply arrangement, administration of the business and Public Energy Company specific marketing.

Given the above objectives and based on previous experience of developing delivery vehicles for Public Sector organisations, consideration has been given to potentially suitable legal forms in the table below, along with outline descriptions for each and

other relevant commentary. The options have been developed and shortlisted by advisors however they are subject to full, thorough legal review.

Table 34 - Possible commercial structures

Company Limited by Shares (CLS)

A private company limited by shares is a company that is managed by directors and owned / controlled by shareholders. CLSs are easily understood structures and backed by the Companies Act 2006.

A CLS can trade, raise finance and invest in or be sold to third party investors.

A CLS is liable to corporation tax on any taxable profits arising within the company.

Should the CLS be dissolved any surplus would ordinarily be distributed to the shareholders in proportion with their interests.

Company Limited by Guarantee (CLG)

A CLG is a legal form of organisation which is typically established to conduct business for the benefit of the community. As above, we assume the CLG will be a "not for profit" entity on the basis that any profits arising will be used to reduce fuel costs for customers.

The organisation may "trade" but only in accordance with its objects. Profits will not be distributed and instead will be reinvested for community benefit. Financing is largely achieved through external loans.

A CLG is a body corporate and is subject to corporation tax on its taxable profits.

A CLG may be charitable, in which case if approved by HMRC certain sources of income may be exempt from corporation tax. Further information about the tax benefits of charities is provided below.

Under this approach the Public Energy Company could be set up as a Charity, with a trading subsidiary company (enabling the trading activities of the White Label company to be kept separate from any other energy initiatives the Public Energy Company may wish to pursue in future).

Community Interest Companies (CICs)

A CIC is a company that can be formed as a CLS or CLG. It is a limited liability company that is specifically designed for social enterprises aimed at providing a benefit to a community.

A CIC includes provisions such as an asset lock which would mitigate against any future disposal to the private sector and consequent realisation of the public sector's investment, although it is noted that this is not an 'exclusive' benefit of a CIC.

Profits and assets must be retained within the CIC for community purposes.

As a company, any income or gains arising will be subject to corporation tax. A CIC cannot have charitable status.

If the CIC is dissolved, any assets held can be transferred to another CIC or a charity.

Community Benefit Company or Society (CBCS) or Industrial and Provident Society (IPS)

Involves the provision of services through a “not for profit” entity. The community benefit organisation may be a company limited by guarantee (CLG), Industrial and Provident Society (IPS) or a Community Interest Company (CIC). The organisation will conduct business for the benefit of the community. May be established as a charity if it has charitable objectives.

There should be sufficient powers to participate in the organisation under incidental, wellbeing or general power of competence. The organisation may “trade” (unless it is a charity) but only in accordance with its objects. Profits will not be distributed and instead will be reinvested for community benefit. An IPS will be able to raise share capital but a CLG will not. Otherwise finance will be raised through loans.

The community benefit organisation may have a contract for services with the Public Sector investors provided this has been awarded in compliance with public procurement rules. Alternatively, the organisation may be a standalone service provider. The organisation will contract with third parties in furtherance of its business

A CIC includes provisions such as an asset lock which would mitigate against any future disposal to the private sector and consequent realisation of the public sector’s investment.

CLGs are commonly used in the public sector. A CLG is more suitable to a body that is not designed to be a wealth creator for the members, but rather a vehicle to manage specific activity. A CLG would not facilitate any future disposal of the Public Sector investors' interests to the private sector. A CLG is liable to pay tax. Should the CLG be dissolved any surplus could be distributed to the members in proportion with their interests.

An IPS is a society with a co-operative structure that is established for member benefit rather than public benefit. A key feature is the ‘one member, one vote’ principle although there are several different types of cooperatives. They cannot be charitable, except possibly in a case where a necessary condition of membership is to be within a class of charitable beneficiaries (for example, being a resident in financial need in an area of deprivation).

Limited Liability Partnership (LLP)

A limited liability partnership is a hybrid of a company and a partnership. Like a company, an LLP is a separate legal entity and an LLP member’s liability is limited. The relationship between the members of an LLP is governed by private agreement. An LLP does not have shareholders or directors and is taxed like a partnership. The main advantage of an LLP structure is that the limited liability protects the member’s own assets from the liabilities of the business. Profit cannot be retained by an LLP like a company can, it should be distributed each year. However, as the Public Energy Company will be a not-for-profit entity with any

surpluses reinvested into helping alleviate fuel poverty, this is an issue that it should be possible to mitigate against.

From the above we can see that any of the company structures discussed have the potential to deliver the Public Energy Company's objectives and requirements. However, the structure chosen, particularly where there are a number of vehicles involved in the structure (as discussed in the tax section below), will ultimately depend upon the advice of Scottish Government's legal advisors, who can assess the various structures from a legal perspective and advise on the most appropriate form in conjunction with our tax advice.

There are several important considerations when determining the potential legal form of the Public Energy Company. The key considerations that Scottish Government need to address are as set out below:

Table 35 - Legal structure requirements

Consideration	Comments
Control and governance	The Scottish Government have a number of key strategic objectives that it is seeking to realise through the Project such as supporting reducing fuel poverty and supporting existing energy policies. It would therefore wish to retain some control over the governance of the Public Energy Company to ensure it can align with these broader objectives.
Stakeholder management	The Scottish Government recognises the need for Local Authorities to be involved in and invest in the Project. Due to the nature of the Public Energy Company and its association with Scottish Government, there are a number of key stakeholders who's wants need to be managed, not to mention 'interested parties' who will be paying close attention to the development of the Public Energy Company.
Growth	The Scottish Government have longer term goals to expand the aims and operations of the Public Energy Company in future. They will therefore wish to have the capacity to, for example, evolve the Public Energy Company into a Fully Licensed energy company. The chosen commercial structure therefore needs the ability to grow with the Public Energy Company.
Exit strategy	Public Energy Company owners may desire in future to be able to exit from the Public Energy Company if it is not delivering to their broader objectives.
Self-financing	Over the medium term, the Public Energy Company must generate sufficient income (following initial investment costs) to fund its own operations.

State aid compliant	The structure and related contractual documentation of the Public Energy Company should be compliant with relevant State aid requirements.
Tax efficient	The aim is for the Public Energy Company to reinvest surpluses to address fuel poverty and other energy inequalities in Scotland. As such the Public Energy Company intends to be a not-for-profit entity and a commercial structure which minimises the risk of tax leakage is required.

Based on the above, it is anticipated that the Limited Liability Partnership could have the greatest potential to deliver against the Public Energy Company's objectives and requirements.

However, further consideration of the potential commercial structures is given below.

5.5 Alignment of proposed commercial structures to the objective

This section considers the alignment of the three shortlisted commercial options in terms of:

- Responsibilities
- Ownership and control
- Procuring goods and services
- Funding and financial incentives
- Supply

As the Project proceeds into commercialisation and procurement, we recommended the commercial structures options are thoroughly reviewed by legal advisors.

We have also set out below the high-level tax considerations of the potential vehicles that SG could use for this scheme. However, we would highlight that this report does not consider the detailed tax position for each of the potential vehicles. We recommend that further detailed work is undertaken to model the corporation tax position for the vehicles and potential structures.

Table 36 - Legal structure of Option 1 - Company Limited by Shares (CLS)

Element	Comments
Ownership/control	<ul style="list-style-type: none"> • Public Sector entities, who have opted to invest in the Public Energy Company, will be shareholders in the CLS and will enter into a Shareholders' Agreement. • The shareholders have roles and duties to perform for the CLS, as specified and described in the Companies Act 2006 and the CLS's articles of associated.

Element	Comments
Procuring goods and services	<ul style="list-style-type: none"> • The Limited company will procure an agreement with a selected third party energy supplier who will act as the White Label provider and will provide gas and electricity to the Public Energy Company's customers.
Funding & financial objectives	<ul style="list-style-type: none"> • Public Sector investors will fund the capital cost of the set up (by way of equity and/or debt finance). Noting that the use of White Labelling will limit capital costs significantly compared to other delivery options, such as Fully Licensed supply.
Other	<ul style="list-style-type: none"> • Shareholders in the CLS limit of financial responsibility is restricted to the value of the shares they hold. • A CLS is liable to pay tax and therefore profits would be taxable under corporation tax laws.
Tax considerations (non-charitable company)	<ul style="list-style-type: none"> • A CLS or non-charitable CLG / CBS will be subject to corporation tax on its profits. The current rate of corporation tax is 19% (expected to reduce to 17% with effect from 1 April 2020, although this could be subject to change). • As outlined above, where the non-charitable company is a subsidiary of a charity, it may be possible to shelter taxable profits arising through payments of gift aid to a parent charity. • This report does not consider the determination of taxable profits further, but we recommend that further detailed work is undertaken to model potential corporation tax costs, should the Government choose to set up a non-charitable company.
Tax considerations (charitable company)	<ul style="list-style-type: none"> • Charities are exempt from corporation tax on certain sources of income received (an important exception being trading profits which could include the receipt of commission from energy suppliers – but see further below). • A charity can be established as a CLG or CBS and will need to be verified by HMRC as a charity before it can avail of reliefs and exemptions. • In principle, and subject to obtaining legal advice, the Charity could be used as a vehicle for administering the surpluses generated to customers who are determined to be in fuel poverty. This would potentially be in accordance with a charitable objective of alleviating poverty. • SG should consider establishing a Charity and a wholly owned subsidiary which will conduct any trading activity. This will have the benefit of separating out the trading activities of the White Label company from the Charity's function to receive surplus receipts and redistribute them to the ultimate customers. A trading subsidiary would be subject to corporation tax on its profits but is potentially able to shelter

Element	Comments
	<p>its taxable profits through payments of gift aid to its parent charity.</p> <ul style="list-style-type: none"> • We would highlight that the practicalities of the scheme would need to be reviewed to consider whether a structure involving a Charity and a wholly owned subsidiary is appropriate. Further consideration should be given to the purpose of the Charity and how surpluses will be distributed to customers deemed to be in fuel poverty.

Figure 2 - Structure under Option 1 - CLS

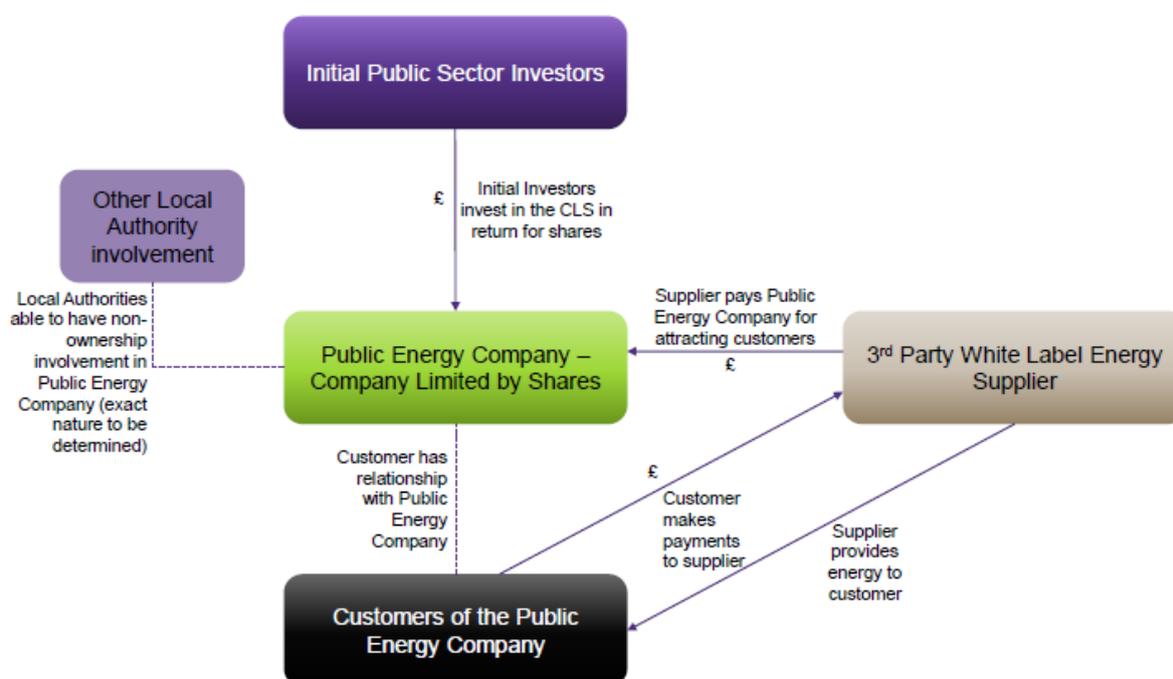


Table 37 - Legal structure of Option 2 - Community Benefit Company or Society (CBCS)

Element	Comments
Ownership/control	<ul style="list-style-type: none"> • Under this option, the Public Energy Company would be set up as either a Company Limited by Guarantee (CLG), Industrial and Provident Society (IPS) or Community Interest Company (CIC). The Public Energy Company would be controlled independently, with neither Scottish Government or Local Authorities controlling the entity. • Due to the lack of control retained by Scottish Government and Local Authorities under this option, the ability to influence the entity and its operations is more restricted.

Element	Comments
Procuring goods and services	<ul style="list-style-type: none"> • The CBCS will procure an agreement with a selected third party energy supplier who will act as the White Label provider and will provide gas and electricity to the Public Energy Company's customers. • As the CBCS will operate independently of the Public Sector investors, any services which can be provided by them, such as Public Energy Company Specific marketing, may contract with the Public Sector investors for these services. However, these services must be awarded to the provider in compliance with public procurement rules. This requirement to comply with public procurement rules could result in additional time and resource required for set up.
Funding & financial objectives	<ul style="list-style-type: none"> • The form of funding will depend on whether the CBCS is set up as a CLG, IPS or CIC. An IPS can raise share capital but a CLG cannot. Otherwise, funding will be in the form of loans.
Other	<ul style="list-style-type: none"> • Profits are not distributed under this option, with any surpluses generated being reinvested for community benefit, this is in line with the Public energy Company's intentions for surplus funds generated.
Tax considerations	<ul style="list-style-type: none"> • Any income or gains arising in the CIC will be subject to corporation tax. However, if this vehicle does not lend itself to sheltering taxable profits if any surplus would be retained by the CIC rather than donated to a charity. • On this basis, we do not expect a CIC to be an appropriate tax efficient structure, as it is likely to be subject to corporation tax on its receipt of commission and may not be able to claim relief for application of surplus to alleviate fuel poverty.

Figure 3 - Structure under Option 2 - CBCS

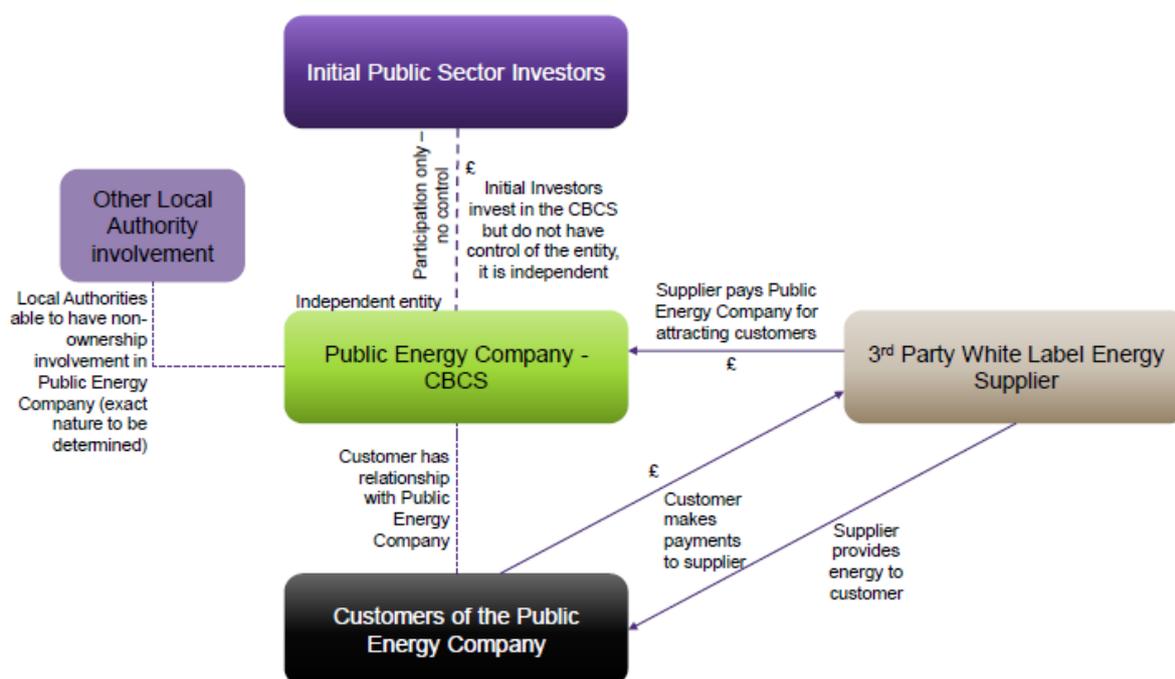
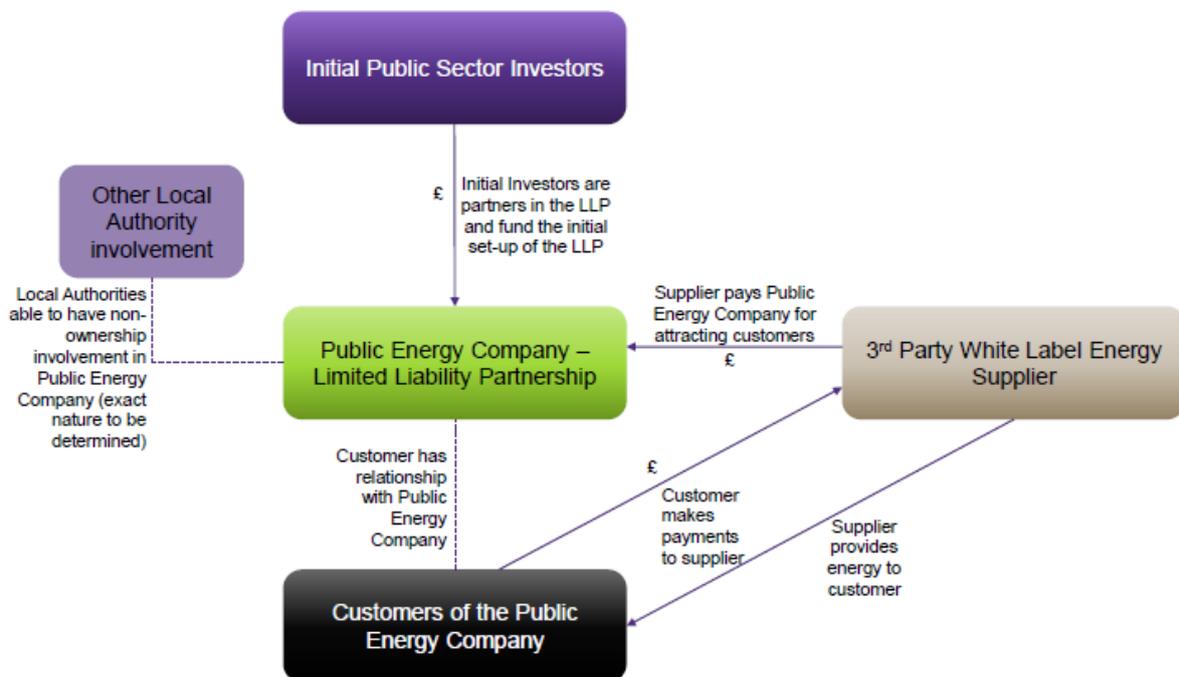


Table 38 - Legal structure of Option 3 - Limited Liability Partnership (LLP)

Element	Comments
Ownership/ control	<ul style="list-style-type: none"> Public Sector entities who have opted to invest in the Public Energy Company, will be partners in the LLP with those other parties which opt for partnership in the Public Energy Company. The parties will enter into a Limited Liability Partnership Agreement, setting out the terms of the investments and to establish the terms of the relationship.
Procuring goods and services	<ul style="list-style-type: none"> The LLP will procure an agreement with a selected third party energy supplier who will act as the White Label provider and will provide gas and electricity to the Public Energy Company's customers.
Funding & financial objectives	<ul style="list-style-type: none"> The investors will fund the capital cost of the setup, noting that the use of White Labelling will limited capital costs significantly compared to other delivery options, such as Fully Licensed supply. Partners in an LLP are not personally liable when an LLP cannot pay its debts and therefore their liability is limited to the capital they have invested into it. An LLP therefore helps to reduce risk to the participating parties as the main advantages of an LLP

Element	Comments
	<p>structure is that the limited liability protects the member's own assets from the liabilities of the business</p>
Other	<ul style="list-style-type: none"> • In an LLP, the partners receive untaxed profits and pay tax themselves on earnings and the LLP itself does not pay tax. However, as the Public Energy Company will be a not-for-profit entity, with any surpluses being reinvested into helping alleviate fuel poverty, this is unlikely to be an issue.
Tax considerations	<ul style="list-style-type: none"> • As outlined above, an LLP is generally a tax transparent vehicle provided it is carrying on a business with a view to profit. If this is the case, any profits arising in the LLP should be subject to tax on the partners in the LLP. • Given that the members of the LLP would be likely to be tax exempt public authorities (which needs to be confirmed), then this structure, if it is workable from a legal perspective, could allow both flexibility (for Local Authorities to join as new members) and tax efficiency. • One key aspect to consider is the ability for the LLP to retain its surplus to apply for alleviating fuel poverty (or for each member to allocate its surplus for that purpose). As mentioned above, the LLP itself needs to be carrying on a business with a view to profit. In principle we consider this test may be capable of being met, if the application of surpluses by the members to relieve fuel poverty is a separate decision made by the members through the LLP agreement. • We would strongly recommend that the viability of using a LLP is tested further with your legal advisers.

Figure 4 - Structure under Option 3 - LLP



Funding

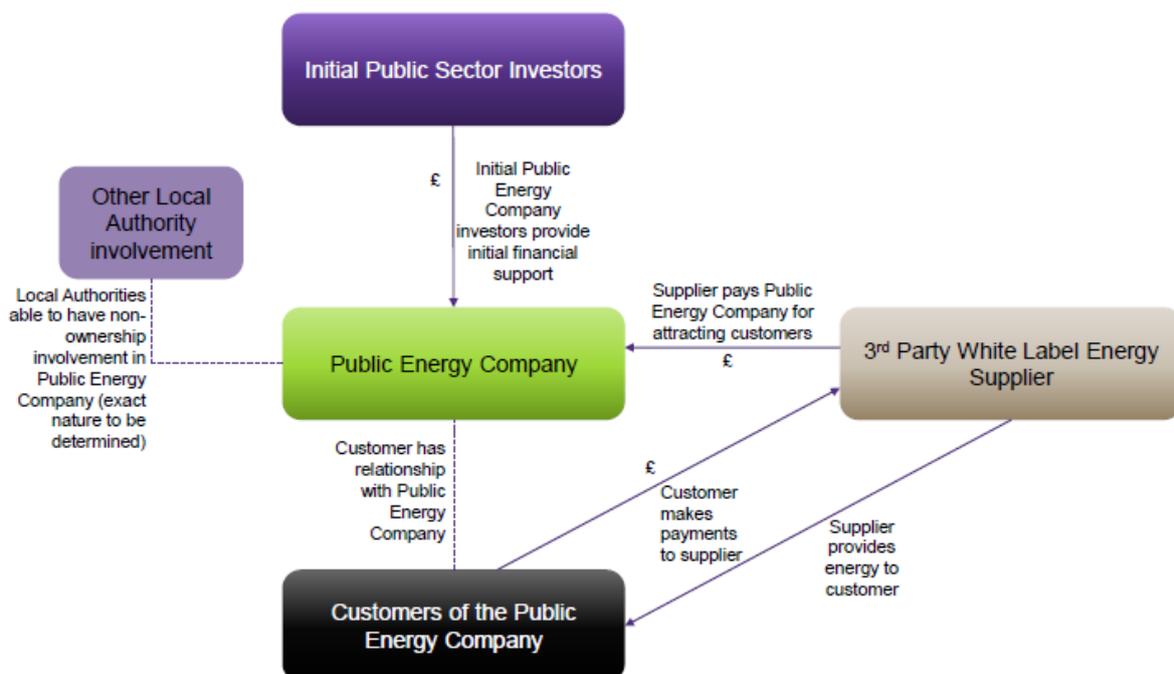
The proposed initial phase arrangements for the Public Energy Company has no capital requirement. Additionally, many of the support functions which the Public Energy Company will require shall be met by the commercial partner to the Public Energy Company and negotiated as part of the White Label supply arrangement. There are, however, various initial set-up costs and associated working capital requirements – the assumptions surrounding these are detailed in the Financial Case (note, procurement costs are excluded from this assessment).

It is anticipated that there will be Public Sector involvement in the establishment of the Public Energy Company, with Local Authorities given a degree of flexibility over the level of their involvement in the Project. Therefore, the exact source of funding will partially depend on the appetite of individual Local Authorities to invest directly into the Project. There are 32 Local Authorities in Scotland who may choose to participate and/or invest. While the tariffs of the Public Energy Company will be available to all domestic customers in Scotland (and indeed the United Kingdom), it is anticipated that the initial focus of the targeted advertising of the Public Energy Company will be towards those Local Authority areas where the relevant Local Authority has contributed to the running costs of the Public Energy Company.

The proposed ownership structure of the Public Energy Company is shown in the figure below. Owners of the Public Energy Company are represented at the top of the diagram. The proportion of ownership amongst different stakeholders is to be determined, based on further discussion with the Local Authority cohort on both an

individual and combined basis. In effect the structure proposed allows for a ‘sliding scale’ of ownership and involvement. It is hoped that ultimately the Local Authority cohort will want to ‘take ownership’ of the Public Energy Company as their own – as such a commercial structure has been proposed that allows for stakeholders in the Public Energy Company to have clear and plausible exit options. The structure below allows for this flexibility and also allows for Local Authorities who, for whatever reason may not initially wish to invest in the Project, to do so at a future point in time. For example, it is possible that once the Public Energy Company is established and operating, more Local Authorities wish to get involved.

Figure 5 - Public Energy Company structure diagram



5.6 Governance Arrangements

Under the preferred commercial structure and associated funding approach, Scottish Government would retain a degree of delivery and financial risk for the Project. It is therefore important that Scottish Government has in place rigorous and robust procedures for monitoring the progress of the Project, both during the development stages and its active operation, and its financial viability going forward.

Under the commercial structure adopted, there will need to be appropriate governance arrangements in place to enable the Public Energy Company to operate flexibly and without undue involvement from company owners, whilst maintaining the necessary oversight and control to reflect the investment of public funding and responsibilities of Scottish Government. Key to achieving this will be:

1. A clear matrix of delegations from Scottish Government and Local Authorities to the board of the Project entity;
2. A clear allocation of function between Scottish Government, Local Authorities and the Public Energy Company and a governance structure which is reflective of this;
3. Details of how potential conflicts between Scottish Government, Local Authorities and the Public Energy Company are to be resolved;
4. Alignment of the business decision made by the Public Energy Company with Scottish Government;
5. Ensuring all directors/responsible individuals appointed to the board(s) of the Public Energy Company receive training in their roles and responsibilities;
6. Other set up requirements such as policies and procedures are adequately addressed.

5.7 Risks and potential for risk transfer

This section considers the risks associated with the Project and the potential mitigations provided by White Label supply as the preferred option.

Table 39 - Risks and mitigations

Risk	Comments	Mitigation
Energy prices	Fluctuation in wholesale gas and electricity prices could impact the prices the Public Energy Company is able to secure with the Energy supplier and ultimately impact the cost to customers.	The term and conditions of the White Label agreement will help to mitigate this risk. Energy companies usually also enter into forward contracts for the purchase of energy which can help to reduce the impact of changes in wholesale prices have on the end customer. The

		ability to negotiate these contracts will depend on the experience and size of the energy company.
Insufficient sign up levels	There is a risk that there is not sufficient uptake by customers for the Project to be viable and to ultimately deliver on the objective of helping to alleviate fuel poverty.	A structured and well-developed marketing strategy as well as securing the best White Label agreement will help to encourage disengaged customers to switch from their current provider, coupled with an engaged Local Authority cohort committed to educating their residents on the benefits of switching
Reputational risk	There is a risk of adverse publicity or association resulting from poor offering or service provided by the Public Energy Company. Due to the relationship with Scottish Government this Project involves there is an increase in the level of public scrutiny it is likely to receive. This could impact Scottish Government, Local Authorities and the White Label energy supplier.	Ensuring the terms of the White Label agreement are thorough and clear and that the chosen supplier's values align with those of the PEC will help to mitigate this risk.
Regulatory requirements	There is a high level of regulation in the energy market which can be costly and time consuming to ensure compliance with.	By partnering with a supplier under a White Label arrangement, much of the regulatory requirements will be met by them, greatly reducing the cost and resource burden on Scottish Government and Local Authorities.

5.8 Commercial considerations

Project sponsor and entity

The preferred commercial option involves a 100% public sector ownership model, with the proportions of ownership of different public sector organisations to be determined through ongoing discussion and engagement with Local Authority representatives. The ownership model will be legally defined in the commercial particulars and will ensure that strategic control is retained by the public sector partners. The nature of each element of the commercial considerations discussed below will be refined based on the progression of the ongoing discussions with Local Authorities and the subsequent commercialisation and procurements phases, identified partner supplier appetite, and the assessing of agreements and arrangements that are considered likely to provide the outcome the public sector partners wish to achieve.

Energy Supplier

The Public Energy Company will put in to place contractual arrangements for supply of energy to the Public Energy Company Customer base. This agreement will be reached with the identified supplier following commercialisation of the Project and negotiation with potential suppliers in the procurement phase. A competitive procurement process will be used to identify a suitable partner and help ensure an alignment of values with the Public Energy Company's aims. This is intended to be a long-term contract, incentivising the energy supplier to provide a quality of service to both the Public Energy Company and the identified customer base. This arrangement should also allow the public sector bodies to transfer a significant level of the operational risks to a third party. In reaching agreements with the third party energy supplier there is a balance to be struck between accepting risk by the client managing across contract boundaries, and the value that may be lost by outsourcing the responsibility. This will be examined further in the commercialisation phase and will be influenced by the outcome of the soft market testing to better understand market appetite.

Customers

The nature of the Public Energy Company utilising a White Label arrangement with a partner supplier is that the customer base will be 'owned' by White Label supply company. However, despite this, the perception of the customer base is that their arrangements will be with the Public Energy Company itself. The success of the Public Energy Company will be delivered by its marketing and customer engagement activity actively resulting in customers electing to switch/sign up to the Public Energy Company offering. In order to attract customers to the company, it is anticipated that tariff options that are competitive in the marketplace will be offered. It is recognised that it is unlikely the public Energy Company will be able to provide the cheapest offering on the market, however encouraging customers to switch, and a marketing campaign that moves customers to transfer from higher prices arrangements to the Public Energy Company, allows the Public Energy Company to succeed in engaging customers in reducing their exposure to fuel poverty.

Grid Connection

As a White Label company approach has been selected as the preferred option to pursue, the Public Energy Company will rely on the infrastructure assets of the partner supplier and the wider national grid. It is the intention and desire in future that Scottish Government could support, through the Public Energy Company, the encouragement of localised generation projects. These could be used to encourage small scale energy schemes to generate low carbon energy and provide this for use to the wider economy. In these situations, connection to the Scottish energy grid would be required. As these projects appear and progress, individual arrangements will need to be made with the regional grid owner for the connection of these projects to the grid. While not an immediate concern for the Public Energy Company, this could form part of future phases of the Public Energy Company.

Exit strategies

At a future stage one or more of the Project sponsors may wish to reduce or release their interest in the Project.

Delivering the Project through the Public Energy Company – a separate legal vehicle, will allow the sponsors to refinance (if required) or sell their shares to new investors/partners/existing partners as an exit route in the future if the need arises. For example, if the Public Energy Company was set up as a company limited by shares, sponsors would be able to sell their shares at a future date as an exit route. In addition, the Public Energy Company would have separate financial statements, showing the performance and position of the company, making it easier for other parties to understand the performance of the company.

5.9 Contract structures

The following key contractual arrangements will need to be put in place to implement the preferred commercial solution. They are not considered to be a complete list of considerations and are subject to full and thorough legal review by appointed legal advisors.

- **Shareholder's (or Partnership) Agreement** – between Public Sector investors who wish to take a stake in the Public Energy Company. This will set out the respective roles in funding and governance of the Project.
White Label Supply Agreement – between the Public Energy Company and a suitable White Label energy supplier identified through a competitive procurement process. This agreement will set out the requirements for the supply of energy and the contractual arrangements between the energy supplier and the Public Energy Company regarding remuneration and administrative arrangements and obligations.
- **Lease** – if required as identified, provided from an office provider to the Public Energy Company to provide a space for the limited number of Public Energy Company staff to operate from.
- **Finance agreements** – entered into by the Public Energy Company with the Public Sector investors, setting out the funding and equity/debt arrangements.

Indicative Terms & Conditions will require to be drafted, setting out the key contractual clauses between the Public Energy Company and the identified White Label energy supplier – it is anticipated that these will be developed in detail throughout the commercialisation and procurement phase of the Project.

The Scottish Government will also need to obtain specific legal advice to ensure compliance with relevant regulation, including:

- Vires (legal capacity)
- State aid
- Procurement regulations
- Employment Law
- Regulatory Law
- Financial treatment
- Office for National Statistics (ONS) treatment

The proposed commercial structure should be subjected to a Legal Compliance Check to ensure compliance with relevant legal requirements. State aid considerations are discussed in further detail in the Financial Case.

5.10 Proposed charging mechanism

As noted above, Heads of Terms will need to be developed for engaging in negotiations with potential White Label energy suppliers. The financial model has been developed, building on the economic modelling assumptions made in the Economic Case to present two alternative revenue assumptions in the outputs of the financial modelling.

There are two assumptions in the financial model relating to the revenue stream of the Public Energy Company – the Acquisition and the Retention models.

The exact tariffs offered to customers will be based on the market position and will be developed through the contractual negotiations with the successful White Label energy supplier.

5.11 Marketing Approach

Options

In considering the routes to market for the Public Energy Company, it should be noted that – in the context of its objectives – there are two primary areas on which it will wish to focus, namely promoting the awareness of the Public Energy Company itself and its objectives, and providing the information required to assist consumers in switching to be customers of the Public Energy Company.

As stated in the Economic Case, there is a wider education and awareness aspect associated with the alleviation of fuel poverty. This could include public information campaigns, or the use of a physical location that customers could visit to gain

greater awareness of the energy market. Here, having personal contact rather than a website or a telephone call could prove more beneficial in encouraging energy market participation, particularly with regards to customers who are more at risk of fuel poverty or disengagement with the energy market. This would need to be coordinated with Energy Efficient Scotland.

Suppliers acquire and retain customers through a combination of competitive pricing, good customer service, marketing strategy and spend, as well as additional products and services. This applies, even in the context of the proposed White Label solution.

To participate in the energy market and obtain a lower cost deal, we assume that customers require awareness of and confidence in alternative offers, accurate information, opportunity, time and a suitable financial reward for doing so. We would therefore expect that measures that address such gaps in information and capability would help to encourage participation in the energy market.

Historically, and as highlighted by Ofgem in their annual Customer Engagement in the Energy Market surveys, it is younger people, those deemed to be social classification ABC1, owner occupiers and frequent internet users that are more likely than average to both have engaged and to have switched supplier. Conversely, older customers less frequently switch supplier but were found to be no less likely to switch tariff with their existing supplier.

While the 2018 survey challenges the perception that older customers are less likely to switch online, there remain notable differences in information awareness and switching across age and social grade.

In general, practical experience has shown that Local Authorities entering the supply market believe that their brand can encourage disengaged customers to switch supplier, and therefore increase switching rates, particularly amongst the more vulnerable segments of the population. We assume that the Public Sector investors are operating under the same assumption.

In examining the standard marketing routes, we note the following customary routes to market which could be utilised by the Public Energy Company.

Price Comparison Websites

Price Comparison Websites (PCWs) provide an online function as a Third Party Intermediary (TPI) that allows consumers to review the choices of energy supply contracts available to them.

Online TPIs can be active or passive in that they stimulate engagement from the consumer through alerting them with replacements when their existing contracts are to expire or when a very competitive deal becomes available.

Sales by PCWs have been the main route to market for many new entrants in the domestic market in recent years. The costs for these vary slightly by platform and the supplier being switched to, but average £30-£40/customer for a dual fuel tariff.

Cashback sites

There are several cashback websites which pay consumers a fee if they click through to a third party website and buy a product or service from them. As part of the broader service, such sites typically charge a membership fee. The highest profile and largest are Quidco and TopCashback.

Energy suppliers and PCWs have from time to time offered payments to consumers for energy contracts either directly (as the supplier) or indirectly (through using the switching site).

In April 2019, suppliers promoting switching through cashback sites were typically offering customers £10-£20 for a single fuel switch and £20-£50 for a dual fuel switch – these excluding the commercial arrangement between the cashback site and the supplier itself. The higher payments are typically linked to long term (2-3 year contracts) with additional features, such as boiler cover or broadband.

Telesales

Sales conducted by telephone are typically more expensive than PCW sales but cheaper than face to face sales. Cornwall Insight estimates that the typical cost of route to market is £35-£45/customer on a dual fuel switch.

Face-to-face

Face to face sales are normally split by doorstep sales and event sales. This route to market faces the highest compliance threshold due greater opportunity for mis-selling. Typical sales costs for this route are £50-£65/customer on a dual fuel switch, this also being borne out by information published in respect of the legal case brought against Economy Energy and E (Gas and Electricity)²⁸.

This indicated a tiered structure of payments that rose incrementally for each thousand customers switched within a calendar week, increasing from £25 per fuel to £30 per fuel, i.e. double this amount for a dual fuel switch.

One potential advantage of face-to-face sales in this instance would be as a means by which to promote the wider aims of the Public Energy Company, e.g. through event sales in the form of temporary stands or pop-up shops in local shopping centres, while the former could also be employed in council offices.

This physical presence could be based upon a largely standardised set-up determined by Scottish Government or established around a general template that could be developed to a bespoke local solution better reflecting the needs of each individual authority (discussed further in the Regional branding section below). The cost of this approach would therefore reflect commercial property rates applicable in each location, as well as assumed staffing costs.

Given the physical characteristics of the Scottish market – low population density across a large area – it is expected that face to face sales costs per customer gained would be correspondingly higher to reflect this, particularly outside of the main

²⁸ [England and Wales High Court – Case Against Economy Energy and E](#)

populated areas. This has been borne out by supplier activities in the market to date, with new entrant suppliers typically both entering the northern Scottish market last and competing less actively in this region.

It should also be noted that there is a general perception within the energy supply sector that a customer that switches through a non-online method will be less likely to make further switches once they have made their initial switch. As such, the higher acquisition costs associated with face-to-face switching would need to be considered against the prospect of a longer-term revenue stream from such customers.

Permanent physical location

As an example of a route to market engagement and awareness, the Bristol Energy Hub facility is described by the company as a “unique customer service point” that describes itself as offering “friendly and accessible customer care”.

As well as serving as a means by which to promote Bristol Energy, it also provides general advice relating to the energy sector including on issues such as switching supplier, energy efficiency advice and understanding and paying energy bills. In terms of promoting awareness of Bristol Energy, the Hub is also used as a means by which to showcase issues such as investment in the community, charitable initiatives and social and environmental responsibility.

Although there is no information regarding the effectiveness of the Hub approach, a similar method could be employed by participating Local Authorities. As with the temporary displays, a standardised or template approach could be utilised.

Feedback from the local engagement events conducted in the preparation of this OBC highlighted the importance of face-to-face interaction for older people, which would lend itself to a format that is not exclusively digital or telephone-based.

In particular, one respondent noted that people would benefit from a “one stop shop” where they can find out information on the Public Energy Company, get advice on switching and energy affordability, and find out what initiatives (e.g. energy efficiency, Warm Homes Discount etc.) they are eligible for. Any such costs incurred in providing this service would need to be considered in the context of any potential State aid implications – legal advice would be obtained in order to understand this position.

This is also reflected in research undertaken by Glasgow Calendonian University, which highlights the importance of the face-to-face delivery of information on energy issues, particularly on the subject of fuel poverty²⁹. This also highlighted that the provision of support by telephone and online was “often insufficient for meeting the needs of vulnerable households” – highlighting the potential benefits of a physical presence.

²⁹ [“Never try and face the journey alone: Exploring the face-to-face advocacy needs of fuel poor householders in the United Kingdom.”](#) K.J. Baker, R. Mould, F. Stewart, S. Restrict, H. Melone & B. Atterson. Energy Research & Social Science Volume 51, May 2019.

Regional branding

As stated above, one of the main strengths of Public Energy Companies in general is their ability to utilise their unique brand to engage customers who would otherwise be disengaged with the market.

There is the potential for this to be further enhanced through the use of local regional branding by the Local Authorities involved with the Public Energy Company. Based upon the stakeholder engagement work undertaken it appears possible that there would be additional interests from residents in engaging with their Local Authority over a nationally branded company.

Marketing summary

Publicly-owned energy companies commonly seek to utilise their unique brand to engage customers that have not historically switched, thereby increasing switching rates. At present, the two fully licenced Local Authorities operating in the market – Bristol Energy and Robin Hood Energy – have tried to engage with the local market through the routes above but also beyond standard marketing routes, including through:

- Newsletters
- Educational pamphlets
- Email campaigns
- Workshops and seminars
- Physical shop windows

With only two Local Authorities having a full supply licence, it is still too early to fully understand whether or not councils are able to engage with disengaged customers and increase switching rates in this way.

However, anecdotal evidence and the development of schemes such as fitting smart prepayment meters in social voids and for vulnerable customers suggests that these suppliers are able to reach the targeted customer segments beyond that which a typical supplier is willing/able to do.

The Public Energy Company therefore has a number of available marketing strategies available which would require further detailed analysis to select those likely to yield the best return.

5.12 Procurement strategy

Given the wider public interest element of the roll out of the Public Energy Company, the current working assumption is that a Restricted Procedure process is followed. The Management Case provides detail on the procurement strategy. Throughout the process, it is recommended that Scottish Government have externally appointed Technical, Financial and Legal advisers in place to act in the best interest of the public sector and ensure that the procurement specifications are sufficiently detailed to achieve the desired outcomes. In order to maximise the recoverability of Project

expenditure, it is anticipated that the Public Energy Company will be incorporated and VAT registered in advance of the incurrence of costs relating to the establishment of the operation. The costs of procurement, as not reflecting the costs of the Public Energy Company itself, have been excluded from the assessed costs of the Public Energy Company. The extent of these costs, which will be incurred in bringing the Public Energy Company to market, will vary depending on the procurement approach adopted and the complexity of the desired solution.

5.13 Procurement timetable

A full Project timeline from the OBC through to the Public Energy Company being operational has been outlined in the Management Case section of this OBC – this includes the multiple phase procurement timeline. The timetable has been designed to be flexible to allow for any delays that may be encountered in a competitive dialogue procurement.

5.14 White Label Agreement Contract Length

As part of the procurement stage, the length of the White Label Agreement should also be considered. There are other examples of Local Authority White Label energy suppliers with 3-5 year contract lengths. One option for the Public Energy Company could be to seek an agreement underpinned by a service level agreement (SLA) to help ensure the level of quality and service provided to customers, potentially in conjunction with one or more key performance indicators (KPIs). For example, this could be an initial 3-year contract with an option to extend by one year and then another year, for a total of a 5-year contract, provided the service agreement terms are met. This should be considered further as the Project progresses.

5.15 Market interest and soft market testing

Initial soft market testing has been undertaken, with the primary objective of obtaining feedback on the structuring of the Project vehicles and levels of interest from some potential bidders into any procurement process.

A high-level memorandum was developed and issued to the following entities:

- Bristol Energy
- Ecotricity
- Engie
- Good Energy
- Octopus Energy
- People's Energy
- Robin Hood Energy
- Scottish Power
- SSE

- **Together Energy**

The information memorandum provided the consultees with high level details of the Project, including outlining the opportunity, highlighting risks and outlining key questions Scottish Government were looking for feedback on from the consultees.

The responses were received via email, in face to face meetings and telephone, with initial thoughts on the key questions asked. Detailed below are anonymised the responses of each of the consultees (in no particular order).

Consultee One

Consultee one has values which are in line with Scottish Government aims in terms of helping to alleviate fuel poverty and ensuring fairness for consumers, including keeping prices as low as possible. The company also has values focussing on customer service, call waiting times and email response times as key performance indicators. They would consider being involved in the Project as long as the terms and Public Energy Company's use of funds was in line with their desires as a company. They see the Public Energy Company being set up as a separate entity which they would run under Public Energy Company branding. In terms of timelines, they indicated this would be possible in as short a time as one month (once Scottish Government procurement processes are complete) and therefore do not see the deadline of March 2021 as a concern.

In terms of the focus of the Public Energy Company, Consultee One highlighted that there should be an emphasis on reducing the gap in pricing between prepayment and credit term customers. Bearing in mind that those on prepayment tariffs are historically more likely to be in fuel poverty, addressing this gap in pricing would in itself help to reduce fuel poverty. It was noted that there is an additional cost to suppliers for providing the prepayment service, however this gap can be reduced.

With regards to a preference for either the Acquisition Model or the Retention Model, Consultee One indicated they would not have a particular preference. They would however be keen to discuss/understand further what this income to the Public Energy Company would specifically be used for (see the Economic Case for more details on the operating costs of the Public Energy Company).

Consultee Two

Consultee Two is not interested in being involved the Project.

Consultee Three

Consultee Three is interested in the proposition from the initial memorandum, and welcome further discussion with Scottish Government on the Public Energy Company and key considerations.

They highlighted that they support the stated aims of the Public Energy Company of helping to reduce fuel poverty and encouraging disengaged customers. They are keen to learn more and discuss whether the creation of a new White Label agreement would be able to achieve these aims.

In terms of the Acquisition Model versus the Retention Model, Consultee three does not have a preference at this point and the focus would be on finding a commercial White Label arrangement which is both sustainable, and suitable for all parties.

Therefore, decisions and preferences on this would be pending further discussions with Scottish Government.

Consultee Four

Consultee Four is interested in the proposition from the initial memorandum and are keen to be updated as the Project progresses. This Consultee has White Label involvement currently and are actively pursuing opportunities which are value driven. They also believe they are well positioned to partner with Local Authorities.

In terms of the Acquisition Model versus the Retention Model, Consultee four is flexible on which option the Public Energy Company would prefer. They also proposed a hybrid option between the two, whereby there would be an acquisition fee and ongoing retention fees. As standard, they offer acquisition fee and a retention fee each month however they would be happy to discuss and agree on the best approach for the Public Energy Company.

Consultee Five

Consultee Five is not interested in being involved the Project as they are not currently looking at White Labelling.

Consultee Six

Consultee Six supports Scottish Government's intentions to offer a fair price to consumers, tackle fuel poverty and promote economic development. They would be keen to be involved in the Project however not as a conventional White Label Supplier. Their alternative proposed approach would be to set up a fully licensed energy company on behalf of Scottish Government that could provide white labels to local authorities. The energy company would be wholly owned by the Scottish Government which would allow them to retain full control. The set-up process would duplicate the systems and processes Consultee Six already has which would allow for a quicker and less costly process. Consultee Six provided indicative set up-costs in the region of £500k including both industry requirement set-up costs and operational set-up costs.

Consultee Six believes that fuel poverty issues can be alleviated as part of a bigger solution to offer publicly owned sustainable energy in Scotland. They believe that by being the actual supplier, Scottish Government have an opportunity to deliver real value and could provide a platform for future projects and investments.

Consultee Six would be keen to work with local authorities and mutual organisations to provide energy at fair prices and believe that by working with Scottish Government, they have the potential to make 'mutual and municipal' energy a reality by building a network of partnerships with influential organisations that can deliver real change. They believe this network could transform the energy market in the interests of customers and the Scottish economy.

The following conclusions can be drawn from the market engagement undertaken:

- 1) While not all the parties approached expressed an interest in engaging with the subject of supporting Scottish Government in establishing a Public Energy Company, there was sufficient interest across the space that suggests this is an avenue worth exploring further.
- 2) It should be noted that a number of different methods and approaches were identified by which the market would like to engage with a Public Energy Company. As such, any procurement approach undertaken to facilitate the establishment of the Public Energy Company should seek to avoid being overly prescriptive, in order to allow the market to present their own solutions for engaging with the Public Energy Company, thereby allowing potential innovative approaches to addressing fuel poverty.
- 3) There was no clear preference for a retention or an acquisition model – indeed a hybrid approach was also suggested as a possible solution. As such, the Public Energy Company should have a degree of flexibility in exploring the approach that it thinks will be most beneficial.

In summary, the early market engagement, from those who engaged, was received positively, and a plan for future engagement should be developed as part of the commercialisation process. Under the preferred delivery option, it will be necessary to secure a White Label supply agreement with an existing energy company to energy to the Public Energy Company's customers.

5.16 Summary and conclusion

Based on the analysis undertaken, it would appear that either a charity (set up as a CLG or CBS) with a wholly owned subsidiary (potentially set up as a CLS), or a structure involving an LLP could provide an appropriate commercial structure which is tax efficient. However, we would highlight that a number of confirmations would be required in order to investigate whether this is appropriate. In particular:

- Legal advice should be sought to confirm that the vehicles outlined above are appropriate
- Further consideration needs to be given to the mechanism by which any surpluses are applied

However, as noted throughout, the comments made in this note are for the purposes of informing a discussion on the possible structures that may be considered for the Public Energy Company. No action should be taken by SG without further discussion and obtaining detailed legal advice. We would be pleased to take part in further discussions in conjunction with your legal advisers.

For the purposes of the financial modelling performed in the Financial Case, we will assume that a commercial company is set up, in the form of a Company Limited by shares. As charitable status cannot be guaranteed at this time, we have made the assumption that the Public Energy Company will be exposed to corporation tax on its taxable profits. As the Project progresses to commercialisation and the delivery

structure is refined further, this would represent upside to the Public Energy Company if it were able to mitigate against the requirement to pay corporation tax.

6 Financial Case

6.1 Introduction

This Financial Case examines the benefits and costs of the shortlisted preferred solution. The basis for calculating these benefits is a series of metrics, which result from the commercial structure of the Project and how it is funded. These include the Internal Rate of Return, Net Present Value and overall benefit of the Project.

Initially this section details the approaches and assumptions implemented in respect of the Financial Model, to enable an understanding and comparison between the two alternative sets of assumptions applied (the ‘Acquisition’ model and the ‘Retention’ model – discussed in more detail below), with optimistic and pessimistic criteria applied to these assumptions in order to assess the resilience of the Project. We have also prepared a ‘Counterfactual’ model, which assesses the cost to customers of the Public Energy Company against a ‘business as usual’ position to assess if the Public Energy Company can present an attractive proposition to attract consumers.

For the avoidance of doubt, we present two key options throughout this section, the Acquisition Model and the Retention Model for the White Label Supply option. Each of these two core scenarios has the same underpinning of assumptions, with the following exception:

Table 40 - Core scenarios

Retention Model	Acquisition Model
<p>The Retention Model assumes that, once a customer has switched to the Public Energy Company, that the White Label Supplier the Public Energy Company is partnered with pays a monthly retention fee for each month that the customer remains with the Public Energy Company. This is assumed to be £1 / meter / month (so the supply company pays the energy company £2 a month for a customer on a dual fuel tariff).</p>	<p>The Acquisition Model, in contrast, assumes a £25 upfront payment by the energy supplier to the Public Energy Company for each new customer that switches to the company. There are no follow-on payments from the energy supplier to the Public Energy Company – this approach therefore improves the upfront cash position, but requires the consistent identification of new customers for the network.</p>

This section is structured under the following headings:

- Programme
- Approach to calculating the Financial Outputs
- Modelled scenarios
- Tax assumptions (excluding VAT)
- VAT assumptions
- Indexation applied

- Capital Costs
- Counterfactual – this set out the financial benefit of doing the Project as compared to business as usual, or the ‘do nothing’ scenario.
- State Aid considerations
- Optimism Bias
- Accounting Treatment of the Public Energy Company
- Confirmation of the preferred option

Information on and the assumptions behind operating costs, revenues and the funding structure of the Public Energy Company can be found at Appendix E.

6.2 Programme

The table below describes the timeframe applicable to the creation and set-up of the Public Energy Company. It should be noted that these timescales are estimates, but are considered to be appropriate and deliverable within the constraint of the targeted Public Energy Company operational date. The timings should be viewed as flexible to reflect future developments and information. The timelines will need to be updated accordingly as the timelines for procurement and a date for the operation start of the Project becomes clearer. Given the relatively simple nature of the Public Energy Company, there is also a potential for the timeline to be brought forwards to bring the Project to an operational state more quickly.

Additionally, there is an acknowledgement that the Project is unlikely to be in a position to move straight into the commercialisation and procurement phase from the completion of the OBC. The OBC is expected to go to an iterative stage while the agreed form of involvement from Local Authorities is refined. This is an essential stage as Local Authority involvement is considered to be crucial to the next stage of the Project.

The cash flows for the Public Energy Company have been considered over a period of 10 years from the point of operation. The Financial Model has the capability to assess the Project over a shorter or longer timeframe, if required.

Table 41 - Project timetable

Preparation/Procurement	Operation
Start Date	Start Date
September 2019 – March 2021	Financial year commencing April 2021

Once the Public Energy Company is operational, we have modelled the income and expenditure of the company over an initial 10-year period, with a predicted annual customer growth informing the level of income and costs of the Public Energy Company. Under the core scenarios, the customer projections are as follows. Also assumed within the customer numbers is an annual 10% customer ‘churn’ (none in year 1), so that not only are new additions to the network accounted for, but

assumptions are also made for those customers switching to another supplier. The customer numbers have been based on advisors' knowledge of the market and proven trends (discussed in more detail at Appendix E). The impact on the customer numbers is demonstrated in the table below.

Table 42 - Customer numbers

Year	Opening customer numbers	New customers in year	Assumed customer churn	Closing customer numbers
2021 / 22	-	50,000	-	50,000
2022 / 23	50,000	40,000	(6,879)	83,121
2023 / 24	83,121	40,000	(10,047)	113,074
2024 / 25	113,074	45,000	(13,168)	144,906
2025 / 26	144,906	45,000	(16,209)	173,697
2026 / 27	173,697	45,000	(18,960)	199,737
2027 / 28	199,737	45,000	(21,448)	223,289
2028 / 29	223,289	50,000	(23,957)	249,332
2029 / 30	249,332	50,000	(26,445)	272,887
2030 / 31	272,887	50,000	(28,695)	294,192

Note: As both customer additions and customer churn is calculated on a monthly basis, customer losses vary from month to month (although as customer numbers are projected to increase, so too does the number of customers departing the Public Energy Company).

6.3 Approach to calculating financial outputs

The Financial Model was developed to project the Cash Flows (including developing an income statement and balance sheet), using various financing and financial assumptions.

The outputs of the cost model are the calculation of the annual operational income and expenditure flows. The various outflows include:

- Customer projections
- Revenue streams
- Public Energy company set-up costs
- Ongoing operational costs
- Customer acquisition costs

The purpose of the Financial Model is to give an indication of the financial viability of the Project using a set of assumptions about the revenues and costs of the Project, including the impact of applying a commercial structure that includes (where appropriate) tax and financing costs. Sensitivity analysis has also been undertaken on both the Retention and the Acquisition Models to explore the effects of changes

to key assumptions within the Financial Model. The model produces a pre-tax Project IRR (i.e. excluding the impact of tax and financing assumptions). In addition, it calculated a Projected Investor IRR, based on the assumed levels of equity and debt invested into the Public Energy Company. While it is appreciated that the Public Energy Company is not being developed for the purposes for being a profit generating entity (as surplus cash flows are intended to be used to address fuel poverty concerns in Scotland), it provides a good indication of the performance and profitability (and therefore resource generating capability) of the Public Energy Company. The Investor IRR assesses the value of the returns of the Project, taking in to account all tax implications, debt and / or equity paid in to the Public Energy Company by an Investor, interest received on any debt, and dividends received (which it is assumed would be used to fund fuel poverty targeting activities).

The Financial Modelling assesses the investments needed and the potential returns for each of those investors, having incorporated the tax and any debt financing costs assumed for the relevant scenario. The development of the Cost Model into a Financial Model has:

- Enabled the identification of the optimum Public Energy Company set-up and subsequently stress-tested the key variables.
- Allowed for the review of alternative funding mechanisms for the Public Energy Company prior to finalizing this through Commercialisation.

6.4 Modelled scenarios

As noted above, the Financial Model has been used to calculate the core Retention and Acquisition Models. A number of sensitivities have also been modelled to assess the impact upon these scenarios. These are detailed in the table below.

Table 43 - Project sensitivities

Scenario	Description	Details Acquisition Model
1 / 2	Core Scenarios	<p>As noted in the Introduction, two 'Core' scenarios have been prepared – the Retention Model and the Acquisition Model</p> <ul style="list-style-type: none"> - The Retention Model assumes a monthly payment from the White Label energy supplier for each customer served by the Public Energy Company. The key assumptions supporting this scenario are documented throughout this Financial Case. - The Acquisition Model assumes a one-off payment from the White Label energy supplier for each customer that switches to the Public Energy Company. The key assumptions supporting this scenario are documented throughout this Financial Case.
Scenario variations		
3	Blended	Under this scenario, a blending of the retention and acquisition model is presented, with income received from the energy supplier for each new customer meter joining the company received both an upfront one-off payment of £12.50 (in the same manner as the acquisition model), but also an ongoing retention payment of £0.50 per month (in the manner of the retention model)
4 / 5	Optimistic	The optimistic scenario uses a similar set off assumptions to the Core scenario, however assumptions regarding revenue levels and customer take-up are improved, and projections of cost are reduced, in order to show how the Public Energy Company could develop under favourable circumstances
6 / 7	Pessimistic	The pessimistic scenario uses a similar set off assumptions to the Core scenario, however assumptions regarding revenue levels and customer take-up are reduced, and projections of cost are increased, in order to give an indication of how the Public Energy Company may perform if projections are not as positive as those anticipated under the Core scenario.
Funding sensitivities		

8 / 9	Equity funding	The Core Scenarios assume that the working capital required to fund the development of the Project is made in the form of a revolving loan facility. Under these scenarios this is replaced with a contribution in the form of equity, repaid to the Investor at the end of the Project.
10 / 11	Grant for set-up costs	The Core Scenario assume that the working capital required to fund the development of the Project is made in the form of a 10-year annuity loan facility. Under these scenarios this remains true, however the set-up costs of c.£250k of establishing the company are provided in the form of a grant to the Public Energy Company to reduce the need for debt funding.
12 / 13	Increased interest charge	The Core Scenarios apply an interest rate to debt provided from investors at a rate of 5.09% (refer to Section 6.14 for details). Under these scenarios an interest rate of 11.09% is charged, should the Public Energy Company be identified as a 'high-risk' investment. Again, Section 6.14 explains the reasoning for this.
Pricing sensitivity		
14 / 15 / 16 / 17	Revenues + / -	Under these scenarios, the revenue assumptions used in Optimistic and Pessimistic scenarios replace those used in the Core assumptions, to assess the impact of improved/worsened revenue negotiations, without the other variations seen in the Optimistic/Pessimistic Cases
18 / 19 / 20 / 21	Costs + / -	Under these scenarios, the cost assumptions used in Optimistic and Pessimistic scenarios replace those used in the Core assumptions, to assess the impact of improved/worsened costs occurred, without the other variations seen in the Optimistic/Pessimistic Cases

The scenarios modelled are driven to an extent by the number of customers signed up to the network, as this drives both the revenues received, and influences the costs of the Public Energy Company, through the acquisition costs incurred in gaining new customers.

The projected customer sign-ups under the Core, Optimistic and Pessimistic scenarios is presented in the table below.

Table 44 - Projected customer assumptions

Year	Core scenario – new sign ups	Optimistic scenario – new sign ups	Pessimistic scenario – new sign ups
2021 / 22	50,000	65,000	40,000
2022 / 23	40,000	50,000	30,000
2023 / 24	40,000	50,000	30,000
2024 / 25	45,000	55,000	35,000
2025 / 26	45,000	55,000	35,000
2026 / 27	45,000	55,000	35,000
2027 / 28	45,000	55,000	35,000
2028 / 29	50,000	60,000	40,000
2029 / 30	50,000	60,000	40,000
2030 / 31	50,000	60,000	40,000
Annual customer drop-off (y2 onwards)	10%	8%	15%

6.5 Taxation

Corporation tax

Included within the Financial Modelling performed are various high-level tax assumptions, in order to provide an indication of the likely taxation costs incurred by the Project entity in operation. It should be noted that the intention is for the Public Energy Company to be a not-for-profit entity, that will also explore the possibility for establishing as a charitable entity in order to obviate the need to pay corporation tax. However, for completeness and as this cannot be confirmed at this time, we have assumed that the Public Energy Company is exposed to corporation tax at 17%.

As the Project progresses into the commercialisation phase, further specialist taxation advice will be required, to ensure key areas around taxation are addressed appropriately.

Value Added Tax (VAT)

VAT is assumed in the Financial Modelling at the standard rate of 20%.

Whilst the supply of fuel and power for domestic use is subject to VAT at the reduced rate, this is where the supply is being made to the end consumer. In the structure being appraised this supply is being made by the White Label Supplier. The White Label Supplier holds the contracts with the end consumers and invoices these people directly. As such, it will be for the White Label Supplier to confirm the VAT liability of its various supplies.

The supplies being made by the Public Energy Company are those of an intermediary or agent, and the “customer” of the PEC is the WLS. The PEC will receive payment from White Label Supplier for administering and marketing the scheme and manage the ongoing arrangement. The activities of the PEC should therefore all be subject to VAT at the standard rate. This in turn should allow the PEC to recover VAT in full on the costs it incurs.

Costs of the Public Energy Company are therefore modelled at the standard rate of 20%, with the exception of staff costs and their associated overheads, which are assumed not to attract VAT. No assumptions around changes of VAT rates in future have been included. The Financial Model has been prepared on an annual basis. Therefore, with respect to timings and receipts of payments of cash to or from HMRC, these have been assumed to occur on a quarterly basis throughout the financial year, in April, July, October and January in each year. For the Commercialisation stage of the Project, it is recommended that the VAT assumptions are revisited and the Financial Model be developed further as required to project VAT cash flow timings in accordance with expectations.

From the perspective of consumers who purchase energy from the White Label energy supplier, under the guise of the Public Energy Company, they will incur VAT at the reduced rate of 5% for home energy.

For the avoidance of doubt, the assumption has been made that the set-up costs of the Public Energy Company have been incurred within the commercial vehicle – and that costs incurred before the Public Energy Company is operational are exposed to VAT as described above and recoverable accordingly. This too should be revisited as an assumption as the Project develops.

6.6 Indexation

The application of a commercial structure to the Financial Modelling includes assumptions around Real increases and general inflation. Also included are the financing costs of the Public Energy Company.

The Financial Model uses a price base date of 1 April 2019.

Table 45 - Indexation assumptions

Index	Assumed to be	Applied to
RPIx	Based on Office for Budget Responsibilities Projections to 31 March 2024, then 2.5% after this date	All items not specified below
BEIS Electricity trend (residential)	Based on UK Government Energy & Emissions Projections – Reference Scenario + RPIx	Revenues received in relation to electricity customers
BEIS Natural gas trend	Based on UK Government Energy & Emissions	Revenues received in relation to gas customers

6.7 Discounting

In line with HMT Green Book, the Net Present Value calculation uses discounting at a rate of 3.5% on real (unindexed) values to represent social time preference for years to 1 to 30, and 3% thereafter. The discount rate is multiplied by the RPI applied in a given year in order to calculate the discount rate to be applied to the nominal values.

The discount rates are applied to calculate the Net Present Value to consider the prospective value of a Project over its life. The Financial Model has been prepared for a ten-year operations period.

6.8 Capital costs

As noted throughout the Economic Case and the Commercial Case, the Company structure for the Public Energy Company is very 'thin'. Acting as it does, effectively as an entity engaged in focused marketing activity, with a limited level of administrative activity, it is not anticipated that there are any capital costs required for the company. No assumptions have been made for any capital costs in the Public Energy Company.

6.9 Financial results

The tables in this section describe various financial metrics of the Retention and Acquisition Core scenarios, the pessimistic and optimistic scenarios, and sensitivities tested:

- Project IRR (pre-tax) – This is the returns of the Project before the impact of Corporation Tax and debt servicing costs
- Investor IRR – This is the returns of the Project for Scottish Government based on the funding solution adopted
- Scottish Government NPV – This is the Net Present Value of the Project to Scottish Government based on the funding solution adopted
- Scottish Government Payback Period – this is the period of time required to reach a break-even point, based on the funding solution adopted

Values reported have been calculated over a 10-year operational period and use a Real discount rate of 3.5%, multiplied by the RPIx value.

It is acknowledged that Scottish Government is not developing the Public Energy Company for the purpose of 'generating returns' – however the returns provided from the Public Energy Company can be used for the purposes of funding projects aimed at reducing fuel poverty. As such a more positive IRR position provides an indication of greater surpluses that could be utilised to fund fuel poverty reduction programmes.

6.10 Core Scenarios

The table below shows the results of the Retention and Acquisition Models.

Table 46 – Returns of the Core scenarios

Scenario	Project IRR (pre-tax) %	Investor IRR %	Investor NPV £000s	Investor payback period (years) (nominal)	Initial Investment required £000s	Dividends paid by Public Energy Company £000s
Scenario 1 – Retention Model Core scenario	61.2%	34.5%	12,086	6	2,914	22,540
Scenario 2 – Acquisition Model Core scenario	141.8 %	62.7%	3,251	3	297	5,597

It should be noted that the IRR figures for Investors include the impact of the return on money lent to the Public Energy Company at a State aid compliant rate (assumed to be 5.09%), with the remainder being a reflection of the dividends the Public Energy Company is able to pay which, it is assumed, would be used to address fuel poverty issues in Scotland. The right-hand column in the table above shows the dividends forecast to be paid under each scenario over the ten-year operating period.

This table shows the positive returns of the Core scenarios, with payback periods under the two approaches of 6 years for the Retention Model and 3 years for Acquisition Model. The length of time required for the payback period reflects the up-front investment required to ensure the Public Energy Company has sufficient resources to operate without requiring a further working capital loan. The Scottish Government in these scenarios is 'remunerated' in two ways – being through the payment of interest on debt lent to the Public Energy Company and through the receipt of dividends. These dividends could be utilised for pursuing fuel poverty addressing initiatives by Scottish Government. The figures below demonstrate the cashflow and returns profiles of the Public Energy Company under the two Core Scenarios.

Figure 6 – Operating cash flows - Retention Model

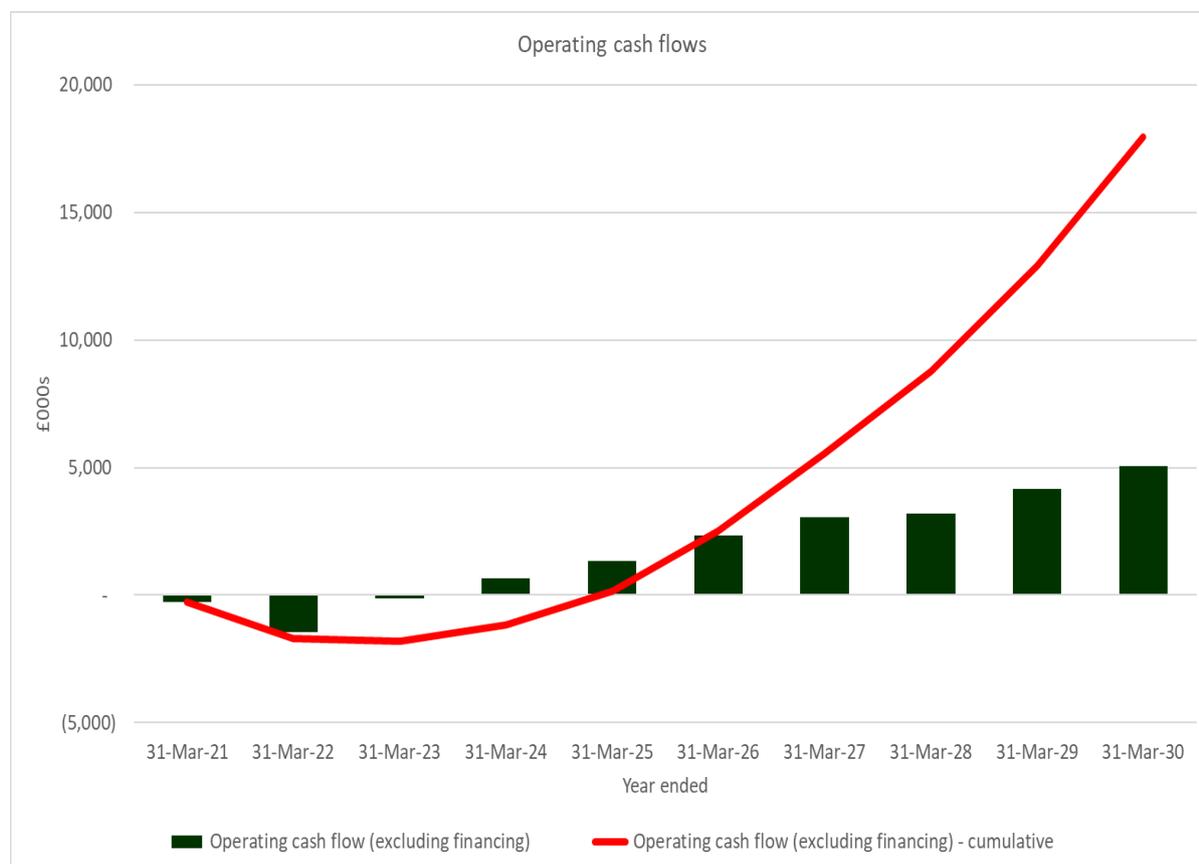


Table 47 - Income & Expenditure summary - Retention Model

Year	20-21	21/22	22/23	23/24	24/25	25/26	26/27	27/28	28/29	29/30	30/31
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
Revenues	-	633	1,551	2,328	3,147	4,519	5,512	5,726	7,070	8,161	8,594
Opex	(261)	(2,072)	(1,668)	(1,664)	(1,821)	(1,820)	(1,821)	(1,830)	(2,020)	(2,026)	(2,041)
EBIT	(261)	(1,439)	(117)	664	1,326	2,699	3,691	3,896	5,051	6,135	6,553
Net financing costs	(131)	(124)	(117)	(105)	(88)	(66)	(48)	(33)	(15)	(3)	13

Net tax charge	71	281	42	(101)	(223)	(474)	(656)	(695)	(906)	(1,105)	(1,182)
Net Income	(322)	(1,282)	(192)	458	1,015	2,160	2,987	3,168	4,129	5,033	5,385

Figure 7 – Operating cash flows - Acquisition Model

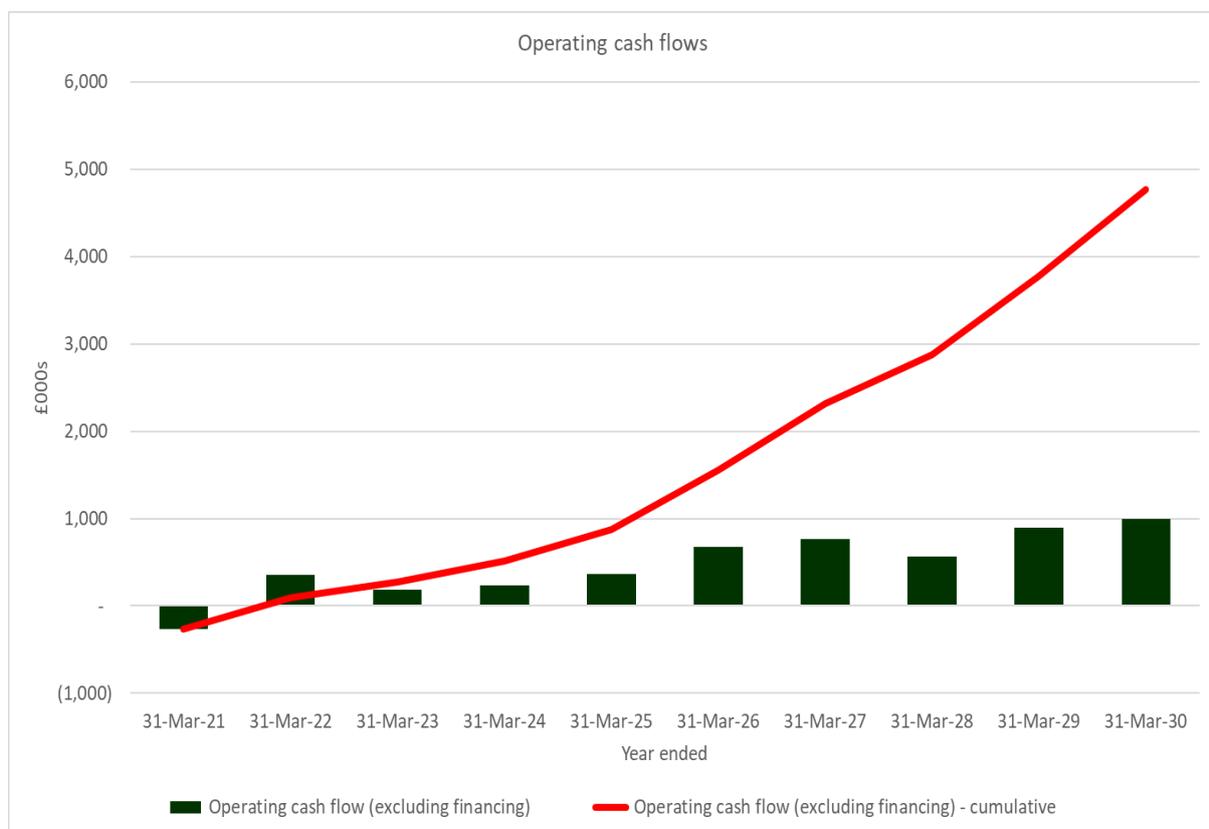


Table 48 - Income & Expenditure summary – Acquisition Model

Year	20-21	21/2	22/2	23/2	24/2	25/2	26/2	27/2	28/2	29/3	30/3
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
Revenues	-	2,434	1,895	1,948	2,260	2,636	2,748	2,524	3,100	3,241	3,146
Opex	(261)	(2,072)	(1,668)	(1,664)	(1,821)	(1,820)	(1,821)	(1,830)	(2,020)	(2,026)	(2,041)

EBIT	(261)	362	227	284	438	816	927	694	1,080	1,215	1,105
Net financing costs	(14)	(13)	(10)	(9)	(8)	(5)	(4)	(3)	(0)	2	2
Net tax charge	49	(63)	(39)	(49)	(78)	(146)	(166)	(124)	(194)	(219)	(199)
Net Income	(225)	287	177	225	353	665	757	567	885	998	908

Figure 8 - Returns - Retention Model

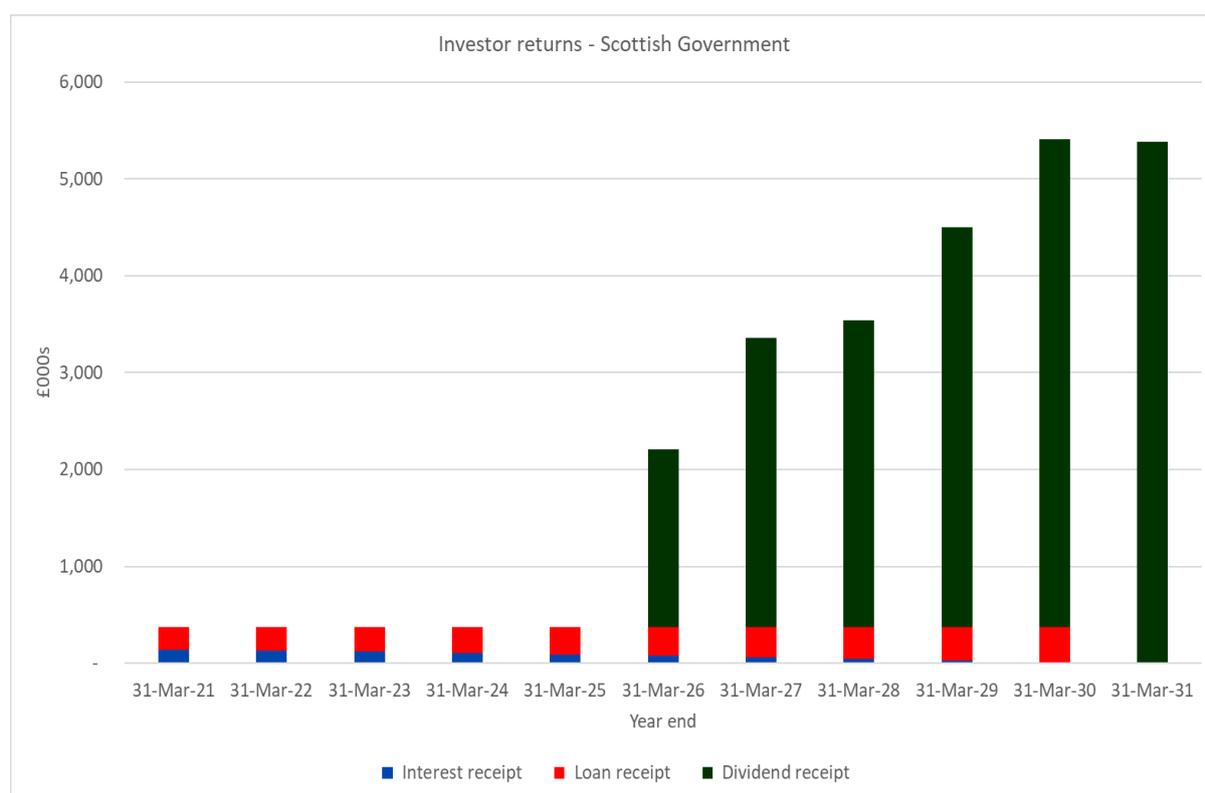


Table 49 – Funding position for investor - Retention Model

Year	20- 21	21/2 2	22/2 3	23/2 4	24/2 5	25/ 26	26/ 27	27/ 28	28/2 9	29/3 0	30/3 1
	£00 0	£000	£000	£000	£000	£00 0	£00 0	£00 0	£00 0	£00 0	£00 0
Loan drawdown	(2,9 13)	-	-	-	-	-	-	-	-	-	-
Interest received	143	131	118	105	91	77	61	45	28	10	-
Loan repayment	229	241	254	267	281	296	311	327	344	362	-
Dividen ds	-	-	-	-	-	1,8 38	2,9 87	3,1 68	4,12 9	4,03 3	5,38 5
Annual position	(2,5 41)	372	372	372	372	2,2 10	3,3 59	3,5 40	4.50 1	4,40 5	5,38 5
Cumulat ive position	(2,5 41)	(2,1 69)	(1,7 97)	(1,4 25)	(1,0 53)	1,1 57	4,5 16	8,0 56	12,5 57	16,9 62	22,3 47

Figure 9 - Returns - Acquisition Model

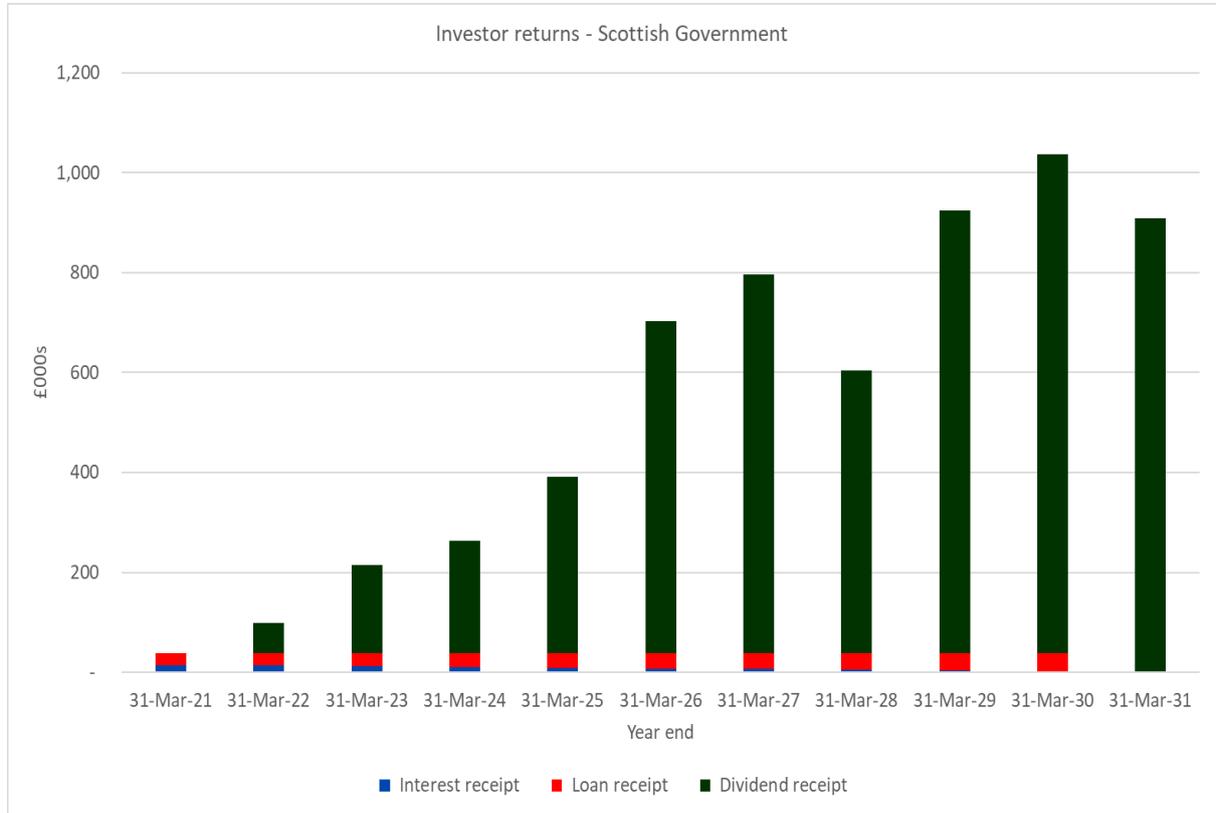


Table 50 – Funding position for investor - Acquisition Model

Year	20-21	21/22	22/23	23/24	24/25	25/26	26/27	27/28	28/29	29/30	30/31
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
Loan drawdown	(297)	-	-	-	-	-	-	-	-	-	-
Interest received	15	13	12	11	9	8	6	5	3	1	-
Loan repayment	23	25	26	27	29	30	32	33	35	37	-
Dividends	-	61	177	225	353	665	757	567	885	998	908
Annual position	(259)	99	215	263	391	703	795	605	923	1,036	908
Cumulative position	(259)	(160)	55	318	709	1,412	2,207	2,812	3,735	4,771	5,679

From these, it can be seen that the Public Energy Company is capable of generating an annual surplus of cash flows while still meeting its debt obligations – particularly in the instance of the Retention Model which is positioned to generate significant dividends.

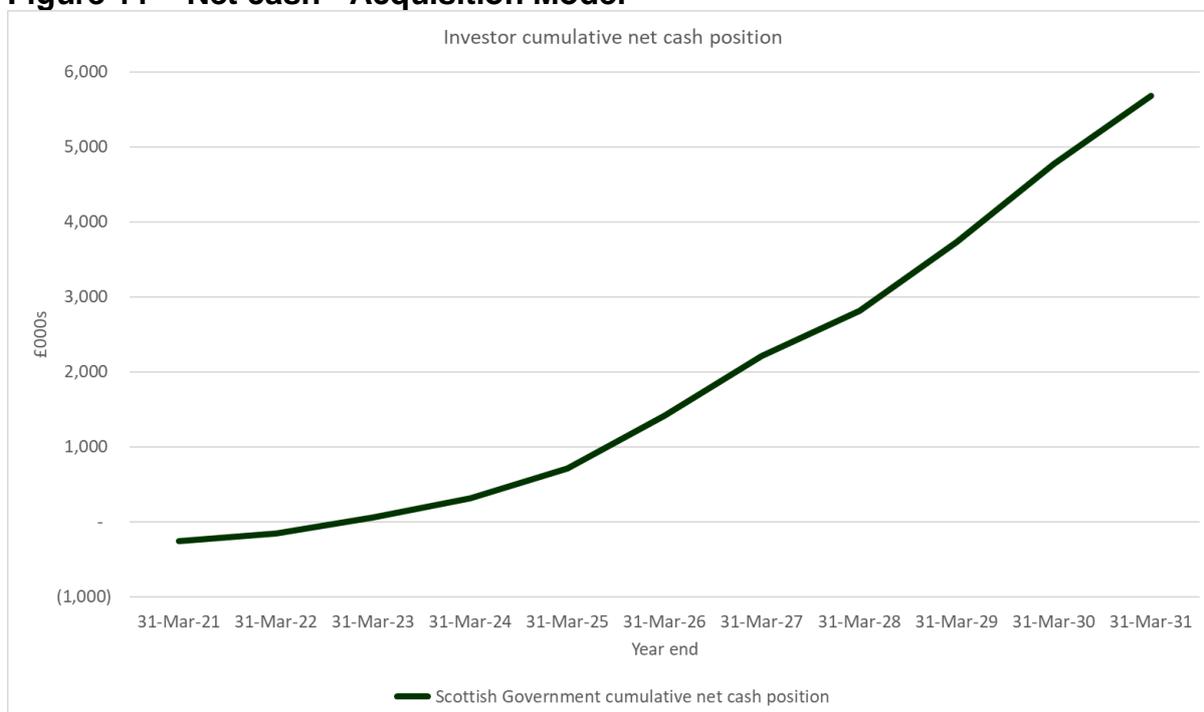
Net cash position

An important consideration for Scottish Government is to understand the net cash requirements placed on it in order to invest in the Public Energy Company. The figures below reflect the net cash position from the perspective of Scottish Government; this includes all cash demands placed on Scottish Government and all receipts from the Public Energy Company. It is shown on a cumulative basis.

Figure 10 – Net cash - Retention Model



Figure 11 – Net cash - Acquisition Model



These figures show that the breakeven point for the Public Energy Company is around the year ending 31 March 2026 under the Retention Model and 31 March 2023 under the Acquisition Model. After this date, based on the assumptions used in the Core scenarios, the Public Energy Company is generating sufficient revenues in comparison to its costs to operate on a self-sufficient basis. However, it should be

noted that there is a potential 'shelf life' for an Acquisition Model – as if company ceases to attract new customers, the Public Energy Company will no longer be viable.

6.11 Alternative scenarios and sensitivities

The alternative scenarios and sensitivities are displayed below. These reflect the optimistic and pessimistic scenarios, alternative funding structures, and sensitivities performed on revenues and costs of the Public Energy Company.

Table 51 - Results of alternative scenarios and sensitivities

Scenario	Project IRR (Pre-tax) %	Investor IRR %	Investor NPV £000s	Investor payback period (years) (nominal)	Investor funding provided £000s	Interest paid on debt £000s	Dividends received £000s
Scenario 3 – Blended Model	71.9%	41.4%	7,727	6	1,205	338	14,152
Scenario 4 – Retention Model – Optimistic Case	117.5%	60.4%	23,000	4	1,489	418	41,115
Scenario 5 – Acquisition Model – Optimistic Case	1062.9%	220.2%	10,359	2	210	59	16,573
Scenario 6 – Retention Model – Pessimistic Case	25.0%	12.1%	2,249	8	6,980	1,962	5,435
Scenario 7 – Acquisition Model – Pessimistic Case	0.0%	5.2%	(364)	8	5,202	1,447	-
Scenario 8 – Retention Model –	61.2%	35.5%	11,890	6	1,852	-	23,231

Equity
funding

Scenario 9 – Acquisition Model – Equity funding	141.7%	61.0%	3,206	3	260	-	5,670
Scenario 10 – Retention Model – Grant funding for set-up costs	61.2%	36.9%	12,313	6	2,475	695	22,841
Scenario 11 – Acquisition Model – Grant funding for set-up costs	141.8%	684.1%	3,497	2	6	1	5,869
Scenario 12 – Retention Model – increased interest charge	61.2%	32.9%	12,169	6	3,647	2,437	21,213
Scenario 13 – Acquisition Model – increased interest charge	141.7%	62.1%	3,260	3	308	205	5,498
Scenario 12 – Retention Model – Revenues + 10%	69.7%	39.1%	14,383	6	2,551	717	26,496

Scenario 13 – Acquisition Model – Revenues +10%	320.6%	105.0%	5,943	2	295	83	9,859
Scenario 14 – Retention Model – Revenues - 10%	44.0%	23.9%	7,416	7	4,136	1,162	14,498
Scenario 15 – Acquisition Model – Revenues - 10%	28.3%	10.7%	386	8	1,748	491	1,014
Scenario 16 – Retention Model – Costs +10%	45.6%	25.7%	8,633	7	4,148	1,166	16,618
Scenario 17 – Acquisition Model – Costs +10%	44.0%	24.1%	1,389	7	798	224	2,674
Scenario 18 – Retention Model – Costs -10%	91.6%	49.9%	15,431	5	1,513	425	27,966
Scenario 19 – Acquisition Model – Costs -10%	482.4%	132.6%	5,165	2	210	59	8,413

Scenario 3: The blended scenario presents the advantages of both the Retention and Acquisition Models, while minimising the shortcomings of each approach. Under this option, the company receives both an upfront acquisition fee and an ongoing monthly retention fee. This reduces the amount of upfront funding required (as the

acquisition approach allows the company to operate profitably from midway through its second year of operation, while also assisting in providing longer term security to the company in the form of the ongoing retention payments, which are (once a critical mass of customers have been received) sufficient to allow the company to continue to operate profitably).

Scenario 4: When the Retention Model is modelled using optimistic sensitivities, the Project IRR increases by 56.3% to 117.5%. This is due to an increase in revenue and customer numbers, together with a reduction in costs. This demonstrates a scenario whereby the Public Energy Company is operating under favourable conditions, both in terms of additional revenue and reduced costs. Investor IRR also improves and the payback period for Investors reduces by 2 years.

Scenario 5: Similarly, when the Acquisition Model is considered under optimistic conditions, the Project IRR increases by 921.1% to 1,062.9%. Again, this is due to additional customer uptake numbers and reduced costs for the Public Energy Company. The Investor Payback Period drops from 3 to 2 years under the optimistic sensitivity analysis for the Acquisition Model.

Scenario 6: Under pessimistic circumstances, the Retention Model's Project IRR drops by 36.2% to 25%. This is due to a drop in the anticipated customer numbers and therefore revenue. Projected costs are also increased which increases the Investor Payback period by from 6 to 8 years and also reduces Investor IRR.

Scenario 7: As above, when modelled under pessimistic circumstances, the Acquisition Model Project IRR drops in this case to 0%. Investor returns drop by 57.5% to 5.2% and there are no dividends to investors. This is due to the combined impact of a reduction in revenue and an increase in costs. Under this set of assumptions the business would not be sustainable as it would require additional funding to maintain its operating position, as it would not be generating sufficient revenue to cover its operating and financial cost base.

Scenario 8: Under this scenario, the Project IRR stays the same as the Scenario 1 – Retention Model as there is no change to revenue and costs assumed however there is a change in the form of the investment the investors put into the Project. Under this option there are no significant variances in IRRs to Scenario 1 however, Investor returns does increase by 1% to 35.5% and dividends increase by £691,000 to £23,231,000. The initial investment required is also lower by £1.06m. This is due to the repayment to investors being at the end of the Project as opposed to being in the form of a loan paid over the duration of the Project. The time value of money there makes this NPV and IRR to investors drop.

Scenario 9: Similarly, there are no changes to the assumed revenue and costs under this scenario therefore the Project IRR stays the same as Scenario 2. However, Investor IRR drops, by 1.7% to 61.0%. However, dividends paid out increased marginally. This is due to the repayment to investors being at the end of the Project as opposed to being in the form of a loan paid over the duration of the Project. The time value of money there makes this NPV and IRR to investors drop.

Scenario 10: Under this model, there are no changes to assumed revenue or costs therefore the Project IRR stays the same as Scenario 1. However, the Investor IRR

increases by 2.4% to 36.9% as a result of the returns of the Project being the same, but a lower level of investment required due to the grant received.

Scenario 11: As with scenario 10, there are no changes to the Project IRR, which is agnostic to funding source. However, the Investor IRR increases as a result of the returns of the Project being the same, but a lower level of investment required due to the grant received.

Scenario 12: Under this scenario the interest charged on debt provided by the Investors to the Public Energy Company is increased to 11.09%, to reflect a likely 'maximum' level of interest that could be assessed as commercial (refer to Section 6.14 for details). The change in the interest rate increases the level of funding initially required, as the Public Energy Company has been modelled to require no further drawdowns of debt beyond its initial funding requirement, and therefore needs a greater level of funds to cover early year debt and interest repayments. However, the NPV and overall returns are not significantly negatively impacted, as both interest and dividends return to the investor.

Scenario 13: Scenario 13 sees a similar outcome to that seen under Scenario 12.

Scenario 14: Under this scenario the Project IRR increases by 8.5% to 69.7% due to an increase in revenues. There is no corresponding increase in costs so the Project IRR and Investor IRR both increase. This scenario assumes the Public Energy Company is operating under favourable conditions.

Scenario 15: As above, under this scenario the Project IRR increases by 178.8% to 320.6% due to an increase in revenues. Again, there is no corresponding increase in costs so the Project IRR and Investor IRR both increase. The significant increase in Project IRR compared to scenario 11 is due to income streams under the Acquisition Model being recurring and this causes any changes to the assumptions revenue in this model to have more of an impact. This scenario assumes the Public Energy Company is operating under favourable conditions.

Scenario 16: Under this scenario the Project IRR decreases by 17.2% to 44% due to a drop in revenues. There is no corresponding increase in costs so the Project IRR and Investor IRR both decrease. Investor IRR drops by 10.6% to 23.9% and due to the drop in revenue and thus surplus funds, the payback period increases to 7 years. This scenario considers a more pessimistic view on revenue, if the entity were not to achieve the revenue figures as anticipated by scenario 1.

Scenario 17: Under this scenario the Project IRR decreases by 52.0% to 10.7% due to a drop in revenues. There is no corresponding increase in costs so the Project IRR and Investor IRR both decrease. As per before, any changes sensitivities applied to the Acquisition Model have a significantly larger impact on the Project's returns due to the annual pattern of income for each customer. The changes are therefore impacted by a multiplied effect. The payback period under this scenario, compared to scenario 2, increases from 3 years to 8 years.

Scenario 18: Under this scenario, there is an increase in anticipated costs by 10%, with no assumed increase in revenue. The Project IRR therefore drops by 15.6% to 45.6%. This scenario takes a more pessimistic view on assumed costs and allows

for costs to be 10% higher than modelled in scenario 1. As a result, Investor IRR also drops by 8.8% to 25.7%.

Scenario 19: As above, this scenario assumes costs are 10% higher than modelled under scenario 2. This results in a drop in Project IRR from 141.8% to 44%.

Scenario 20: Under this scenario, Project IRR increases by 30.4% due to a reduction in anticipated costs with no change to projected revenue. The overall returns of the Project are therefore higher and investors are paid back sooner, with a payback period of 5 years as opposed to 6. Investor IRR also increases by 15.4% to 49.9%.

Scenario 21: As above, under this scenario Project IRR increases by 340.6% to 482.4%. Again, this is due to the drop in costs with no corresponding drop in revenue which results in higher returns and less outgoings. Investors are paid back in 2 years as opposed to 3 as is in scenario 2.

6.12 Counterfactual – ‘Business as Usual’

In addition to the modelled Public Energy Company scenario, we have prepared a Counterfactual scenario. This considers the activities of the Public Energy Company vs. the Business as Usual or ‘No Change’ option. It should be noted that Scottish Government will - under a ‘no change’ scenario - incur no costs and generate no surpluses, this is a straightforward calculation.

Table 52 - Financial Benefit of Retention Model

Description	Real £000s	NPV £000s
Net interest generated under the Public Energy Company (Retention Model)	810	624
Net dividends generated under the Public Energy Company (Retention Model)	22,540	12,290
Total benefit	23,350	12,915
Net cash generated under a Business as Usual position	-	-
Benefit to Scottish Government of the Public Energy Company (Retention Model)	23,350	12,915

Table 53 - Financial Benefit of Acquisition Model

Description	Real £000s	NPV £000s
Net interest generated under the Public Energy Company (Retention Model)	83	64

Net dividends generated under the Public Energy Company (Retention Model)	5,597	3,272
Total benefit	5,680	3,336
Net cash generated under a Business as Usual position	-	-
Benefit to Scottish Government of the Public Energy Company (Retention Model)	5,680	3,336

In addition, the Counterfactual also considers whether the beneficiaries of the Public Energy Company – in this case the domestic customers who sign up to the network, are in a financially improved position as a result of choosing to switch to the Public Energy Company. In order to do this, we have made the following assumptions:

- The same customer cohort is used as for the Public Energy Company
- A 'Business as Usual dual fuel tariff of £94.97 is compared against an implied weighted average tariff for the Public Energy Company of £90.28
- A 'Business as Usual single fuel tariff of £50.33 is compared against an implied weighted average tariff for the Public Energy Company of £48.25
- VAT of 5% is applied
- Tariffs are indexed on the BEIS Electricity (residential) trend

The above reflects (pre-indexation), an annual saving of £58.97 for a dual customer or £26.21 for a single fuel customer. It is not possible at this time to calculate exactly how many individuals this might help to lift out of fuel poverty. As the Project develops to Full Business Case and the tariff can be determined with more certainty, further work should be undertaken to determine how many this assists in lifting out of fuel poverty, while also bearing in mind the additional benefits gained from the money that can be reinvested in to fuel poverty tackling measures.

This results in the following position for customers of the Public Energy Company. As the customers are not impacted on the Public Energy Company being under either a retention or acquisition model, the results are the same regardless of the approach Scottish Government adopts.

Table 54 - Results of the Counterfactual

Description	NPV £000s
Dual Fuel customer costs in Public Energy Company	1,039,888
Single meter customer costs in Public Energy Company	244,467
Total customer costs in Public Energy Company	1,284,354
Dual Fuel customer costs under Business as Usual	1,093,839

Single meter customer costs under Business as Usual	255,022
Total customer costs under Business as Usual	1,348,861
Financial benefit of Public Energy Company to domestic energy customers	64,506

The above calculations demonstrate that there is a potential significant overall financial benefit for the domestic customers switching to the offering made by the Public Energy Company. The values included in both the Public Energy Company scenarios and the Counterfactual scenario are based upon the commercial assumptions. Assumptions made are based on 'best estimates' and knowledge of the market. It is recognised that these are high level assumptions and, as assumptions, for example around customer numbers, are projected into the future, these become less and less certain.

6.13 Sources of funding

The Scottish Government, as a central government body, has access to money from a variety of sources, collectively called the Scottish Consolidated Fund, derived from the following sources:

- Block grant from the UK Government
- EU funds
- Scottish income tax
- Non-domestic rates
- Devolved taxes
- Borrowing

The Scottish Government borrowing would be accessed from the national Loans Fund and the term would be flexible within three to five years at the discretion of Scottish Ministers.

Scottish Local Authorities also has access to funding from the following primary sources:

- Block grant (c.85% of net revenue expenditure, comprised of General Revenue Grant, Non-Domestic Rates Income, and Specific Revenue Grant
- Local taxation (e.g. council tax)
- Borrowing

Scottish Local Authority borrowing is primarily driven around borrowing for capital projects – which is not applicable to the proposed Public Energy Company. However, in certain circumstances Local Authorities may be given a consent to borrow for revenue costs – however this is only possible with the agreement of the UK Government.

Based on the above, it is likely that funding for the Public Energy Company will need to be made from existing reserves. From a financial perspective, Scottish Government and any involved Local Authorities will need to consider the opportunity cost of any investment made in the Public Energy Company – i.e. what else the revenue could be utilised for, and whether that would represent a more appropriate use of resources or offer better returns.

For the purposes of funding the Public Energy Company in the financial model, we have assumed 100% of the funding will come from the public sector, without confirming the explicit source. As such, it is essential that State Aid requirements are considered, as these can impose a floor on the interest rates that can be charged.

6.14 State Aid - Interest rate charged in the Financial Model

To calculate the required rate to meet State aid requirements, reference was made to the European Commission Interest Base Rates³⁰ to identify the effective interest rate for the most recent period. At the date of preparation of the Financial Model, this interest rate was set at 1.09%. Then, via reference to State aid requirements and exemptions³¹, a margin of 400 basis points was applied – the minimum margin required for lending to an entity with no trading history and therefore considered to be higher risk (which would apply to the Public Energy Company as a new entity – regardless of the ultimate ownership of the company. This sets a minimum interest rate for lending from a public sector entity to an arm's length company (although still owned by the public sector) of 5.09%. As a result, a lending rate of 5.09% was set for all scenarios in which lending is provided by the public sector (with the exception of Scenarios 12 and 13).

For the purpose of the Financial Modelling, the decision has been taken to assume lending is made on an arm's length basis – hence the calculation of 5.09% described. We are not aware of the General Block Exemption Regulations (GBER) providing an allowance for the anticipated activities of the Public Energy Company – particularly at its outset in the form of a White Label energy company, however we recommend specific legal advice is obtained to support this assertion.

In the Core scenarios in the Financial Model, the Public Energy Company is assumed to require an injection of debt for all set up and initial operating expenditure requirements, which then has an interest rate applied at 5.09%. This is then repaid to the public sector using a revolving loan facility, in order to maximise the use of available cash and reduce the interest burden on the Public Energy Company.

Under Scenarios 12 and 13 we have applied an interest rate assumption of 11.09% to debt provided to the Public Energy Company. This is to reflect the greatest potential margin identified in reference to State Aid requirements and exemptions, to demonstrate that even under this more onerous interest burden, the Public Energy Company is still, under the Core Scenarios, able to meet its debt obligations.

Both the 5.09% and 11.09% rates are intended as proxies for the actual interest rates that the initial investors would charge and reflects a rate that is likely to be

³⁰ [European Commission Interest Base Rates](#)

³¹ [Big Society Capital – State Aid Requirements and Exemptions](#)

State aid compliant and appropriate for the completion of the Outline Business Case. We would anticipate that as the Project moves to Full Business Case, more rigorous analysis could determine the definitive figure to charge the Public Energy Company and that appropriate legal advice would be obtained to ensure compliance with State aid obligations.

6.15 Optimism bias

In preparing an OBC, it is important to incorporate the impact of optimism bias, to help assess the level of uncertainty over Project costs. Optimism Bias reflects the demonstrated and systematic tendency for Project appraisers to be overly optimistic when considering Project benefits and costs.

Key areas to consider relating to Optimism Bias are:

- Capital Expenditure Optimism Bias
- Operating Expenditure Optimism Bias
- Confirmation of the Preferred Delivery Option

To address this tendency, it is important to make explicit adjustments and thus determine a suitably optimism bias-adjusted outcome. These adjustments will have the effect of increasing the cost estimates, decreasing the projected benefits and extending the timescales over which the costs and benefits are assumed to accrue, compared to the initial unadjusted estimates.

As there are no forecast capital expenditure requirements for the Public Energy Company, no adjustments have been made for optimism bias in the Financial Model.

The principles in Annex 4 of the Green Book and in the HMT supplementary guidance should be applied with proportionate effort in a manner that suits the circumstances. Wherever possible, the relevant adjustments should reflect local experience in preference to use of the HMT generic figures. They should be based on data from past Projects or similar Projects elsewhere and adjusted for the unique characteristics of the Project in hand. When such information is not available, it is encouraged to collect data to inform estimates of optimism, and in the meantime use the best available data.

It is important to be satisfied that the adjustments made are realistic and justifiable in relation to local experience. They should represent a meaningful effort to improve the quality of assumptions rather than arbitrary percentage adjustments.

Consideration of optimism bias to date has been based on the sensitivity testing performed to demonstrate the robustness of the Public Energy Company to these variables. Similarly, the base data prepared through the initial modelling undertaken by Cornwall-Insight is based upon the collection of local data and an understanding of the energy market to reduce the impact of Optimism Bias on the Project. Where various possibilities have presented themselves optimism bias has been reduced through the use of prudent and realistic estimates of obtainable costs and revenues. These have been stress tested further through the application of the 'Optimistic' and 'Pessimistic' scenarios calculated and through the further sensitivities conducted.

The sensitivity testing section of this Financial Case demonstrates the level of resilience of the Public Energy Company.

Further work to quantify the potential optimism bias should be undertaken through the commercialisation phase, once further details of the commercial arrangements are understood.

6.16 Accounting treatment

The modelled commercial option represents a Public Energy Company as a private company limited by shares, with the shares owned by interest Public Sector parties. It is therefore a Public Sector-controlled subsidiary.

Subsidiary companies are defined as organisations that the Shareholder controls by having power over the organisation, exposure or rights to variable returns from its investment and the ability to use its power over the organisation to affect the amount of the return.

6.17 Confirmation of the Preferred Delivery Option decision

In reaching the preferred solution decision, a prudent approach has been taken to the assumptions adopted. For example, an over enthusiastic expectation of the achievable level of customer numbers has not been considered to be applied.

The Core scenarios are considered to represent financially beneficial positions, which generate a sufficient level of income to repay the debt injected to the Public Energy Company and also to generate a modest surplus for use in addressing fuel poverty. This provides an opportunity for the Public Energy Company to establish itself and become a 'known brand' in the marketplace, under Public Sector control, allowing the Public Sector investors to work in unison to lead the decision-making process around future company direction and strategy.

In summary, the preferred financial solution for the Public Energy Company is:

- 100% public sector owned, with the flexibility to allow public sector partners to have an appropriate level of involvement
- Public sector funding is assumed to be provided in the form of a revolving loan facility. 100% of all funding requirements are provided from the public sector.
- The maximum debt required, based on the core assumptions, is incurred in the year to March 2021 and reaches a maximum level of £2.9m under the Retention Model, or £0.3m under the Retention Model.
- Public sector sponsors are currently determining their relative share of this investment.
- Surpluses generated will be paid out of the Public Energy Company and used to fund programmes designed to help reduce fuel poverty in Scotland.
- The proposal has the flexibility to allow for either the Retention or the Acquisition model of generating revenues – this will be refined through discussions with the market in the commercialisation phase of the Project.

This generates the returns as set out in the table below.

Table 55 – Returns of the Core scenarios

Scenario	Project IRR (pre-tax) %	Investor IRR %	Investor NPV £000s	Investor payback period (years) (nominal)	Initial Investment required £000s	Dividends paid by Public Energy Company £000s
Scenario 1 – Retention Model Core scenario	61.19 %	34.45%	12,086	6	2,914	22,540
Scenario 2 – Acquisition Model Core scenario	141.75 %	62.73%	3,251	3	297	5,597

6.17.1 Summary - Public Energy Company vs. Counterfactual financial benefit

We have calculated the benefit to key stakeholders and customers in the Public Energy Company on an NPV basis over the Project life and compared to a 'Business as Usual' scenario over the same timeframe.

Table 56 - Financial Benefit of Retention Model for the Public Sector

Description	Real £000s	NPV £000s
Net interest generated under the Public Energy Company (Retention Model)	810	624
Net dividends generated under the Public Energy Company (Retention Model)	22,540	12,290
Total benefit	23,350	12,915
Net cash generated under a Business as Usual position	-	-
Benefit to Scottish Government of the Public Energy Company (Retention Model)	23,350	12,915

Table 57 - Financial Benefit of Acquisition Model for the Public Sector

Description	Real £000s	NPV £000s
Net interest generated under the Public Energy Company (Acquisition Model)	83	64
Net dividends generated under the Public Energy Company (Acquisition Model)	5,597	3,272
Total benefit	5,680	3,336
Net cash generated under a Business as Usual position	-	-
Benefit to Scottish Government of the Public Energy Company (Acquisition Model)	5,680	3,336

Table 58 - Results of the Counterfactual from the perspective of customers

Description	NPV £000s
Dual Fuel customer costs in Public Energy Company	1,039,888
Single meter customer costs in Public Energy Company	244,467
Total customer costs in Public Energy Company	1,284,354
Dual Fuel customer costs under Business as Usual	1,093,839
Single meter customer costs under Business as Usual	255,022
Total customer costs under Business as Usual	1,348,861
Financial benefit of Public Energy Company to domestic energy customers	64,506

The above calculations demonstrate that there is an overall financial benefit for the domestic customers switching to the offering to market made by the Public Energy Company.

7 Management Case

7.1 Introduction

The purpose of the Management Case is to set out the ongoing Project management and governance arrangements as the Project progresses from OBC to delivery in the form of a fully developed Public Energy Company providing gas and electricity to the domestic Scottish (and wider UK) market.

The Project will be delivered by personnel with experience in the energy sector, with support from Local Authorities involved in the Public Energy Company from the outset and a team of advisers including, financial, legal and technical specialists. These specialists will be appointed prior to the next stage of the Project. For the initial development of the Public Energy Company into a fully formed market offering, it is anticipated that, although not taking ownership of the Public Energy Company, ultimate responsibility will remain with Scottish Government, supported as appropriate by involved Local Authorities.

7.2 Project management arrangements

The current stages of the Project are as follows:

- Outline Business Case – this is the current stage which sets out the Business Case for the Project and how it will be delivered
- Confirmation/revision of the preferred solution through continued engagement with Local Authorities – Local Authorities will be presented with this OBC as the proposed path forwards for the establishment of the Public Energy Company. This process will be open to input and comment from Local Authorities, with the preferred option and OBC revised as necessary to support Local Authority objectives
- Confirmation of Commitment to the development of the Public Energy Company – following any necessary revisions to the OBC, Scottish Government will review the information available and decide whether to progress with the Project on this basis
- Commercialisation Phase – where the initial details regarding commercial agreements start to be negotiated (e.g. White Label negotiations with third party licensed supplier/s, level of involvement and nature of commitment of Local Authorities willing to be involved at the outset of the Public Energy Company)
- Procurement Phase – where, in relation to identifying the appropriate White Label Supplier, a third-party energy supplier is selected
- Final Approval – where the Final Business Case and Final Decision is made and final sign off is obtained from all relevant parties

The Project, up to and including the OBC is being managed by the Consumers and Low Carbon Division, Scottish Government, on behalf of Scottish Government's interests (maintaining an awareness of the aims and objectives of other public sector stakeholders).

As the Project moves into the commercialisation phase, it is likely a dedicated Project Manager will need to be appointed to fully manage the Project and ensure all stakeholders interests are safeguarded to the best of their ability. The Project Manager will have responsibility for Project managing the creation and set-up of the Public Energy Company and the procurement of the partnered energy supply company. The Project Manager will be responsible for the procurement of specialist services, including; financial, technical and legal advisers who will work with the Project team throughout the planning of procurement and implementation.

The proposed structure of the Public Energy Company is that an active energy supply company will enter into a White Label arrangement with the Public Energy Company for the provision of gas and electricity. The details of a potential structure that could be adopted and the reasons behind this are set out in the Commercial Case.

7.3 Project reporting structure and roles and responsibilities

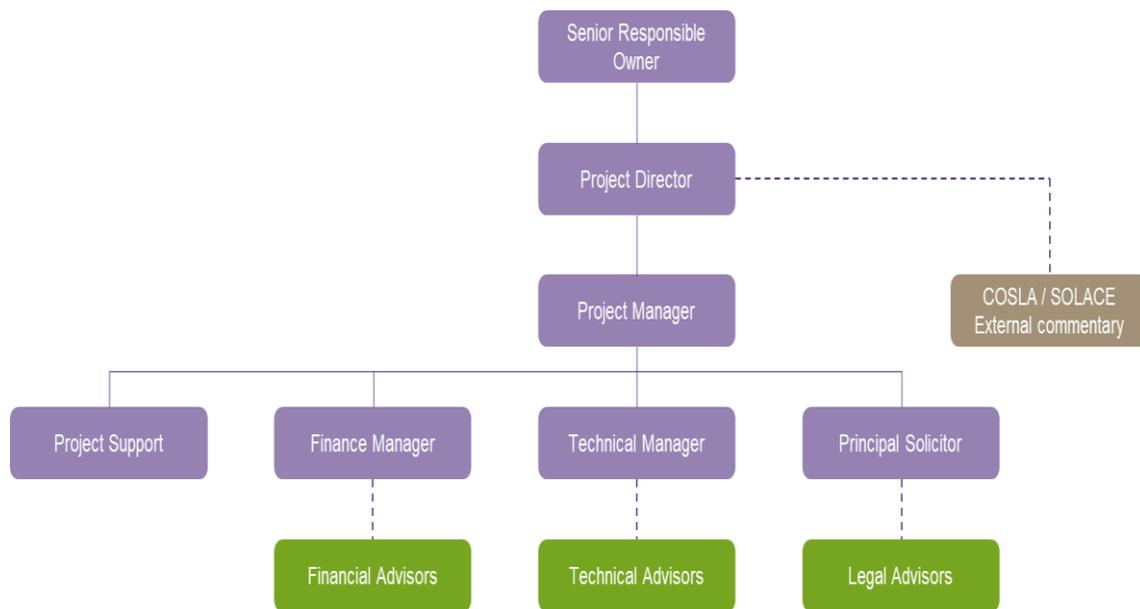
It is anticipated that Commercialisation and Procurement of the Project could take a significant period of time. Due to the time constraints arising from the commitment to deliver the Public Energy Company before the end of the current parliament (March 2021), it is essential that effective Project management is undertaken, with a clear understanding of responsibilities, including communication of ongoing development of the Project with key interested parties and stakeholders.

This will include:

- Providing Scottish Government and other key stakeholders with up-to-date Project developments
- Co-ordinating any conversations with bidders during procurement
- Budget monitoring and approval of spend
- Putting into action key decisions
- Timely communication with bidders

The proposed Project Management Structure is presented below:

Figure 12 - Project Management Structure



7.4 Timetable

The table below sets out the proposed timetable for the next phases in the delivery of the Project. Whilst the timetables are considered to be deliverable by the Project Team, the timetable should be viewed as flexible to reflect the fact that future information is not yet known which could impact upon the length of each stage. The timetable should be updated as and when new information is gathered which could suggest amendments are required. The timetable is therefore projected on a basis considered to be reasonable based on the information known at the time of drafting the OBC.

Table 59 - Proposed project timetable

PHASES	KEY MILESTONE	APPROXIMATE
OBC		
	Submission of original draft OBC	April 2019
	Submission of updated OBC	August 2019
	OBC approved	September 2019
LOCAL AUTHORITY ENGAGEMENT		
	Presentation of OBC to Local Authorities	May 2019
	Consultation and involvement of Local Authorities to determine commitment	May – June 2019
CONFIRMATION OF COMMITMENT		
	Project sponsors formally ratify	Sep – Oct 2019
	Appointment of legal, financial and	Sep – Oct 2019
	Establishment of Project Board and Project Team	Sep – Oct 2019
PROCUREMENT PLANNING		
	Procurement planning period, including pre-procurement supplier engagement	Nov 2019 – Mar 2020
PROCUREMENT PHASE 1		
	OJEU notice published	March 2020
	SQ evaluation	April 2020
	Shortlist approval	April 2020
PHASE 2		
	Issue Invitation to Tender (ITT)	May 2020
	Clarification of ITT requirements	May – June 2020
	Response preparation period	May – June 2020
	Evaluation & clarification	June 2020
	Internal Review and winning bidder	June 2020
	Submit 90% complete Final Business	September 2020
PHASE 3		
	Preferred Bidder confirmed/announced	November 2020
	Contract Finalisation	December 2020
	Finalise & Submit FBC	December 2020
PHASE 4		
	Contract Award	January 2021
	Planning Period	Jan – Feb 2021
	Preparation Period	Feb – Mar 2021
	Service operational	March 2021

Note: The dates presented above are estimates of the timetable through to an active Public Energy Company. This will be further developed through the procurement planning phase. These assumptions should be updated as the Project timelines are finessed

Timelines of the process to an operational Public Energy Company require an awareness of and mitigating strategies for key timetabling risks that could derail the process. All stages of a procurement process are vulnerable to delay.

As a result, there should be established a fully resourced, experienced and dedicated Project Team and a robust risk management structure that will help minimise the risk of delay. The table below sets out the mitigating actions to be applied to help reduce their likelihood or impact.

7.5 Key Timetable Risks

Table 60 - Timetable risks and mitigations

KEY RISK	MITIGATING ACTIONS
OBC not approved within timeframe allowed or not approved at all	Timely submission of OBC to allow for appropriate review within set timeframe; Regular dialogue with Scottish Government to ensure covering desired/required/appropriate areas
Dialogue with Local Authorities takes longer than anticipated	Designated lines of communication between the Public Sector investors Clear processes in place for addressing as far as possible Local Authority concerns; Early buy-in of interested Local Authorities into the Public Energy Company process
Procurement process for White Label supply agreement take longer than anticipated	Dedicated procurement team managing procurement process; Early engagement with the market; Develop comprehensive high-quality procurement documentation and dialogue strategy in advance of OJEU; Deselection of bidders in a timely fashion throughout to streamline the process effectively and focus resources on most likely bids; Regular review of procurement process
Negotiation of Terms & Conditions takes longer than anticipated	Dedicated procurement team managing procurement process; Clear and streamlined Governance procedure with appropriate delegation of decision making to designated individuals

7.6 Decision making in the Public Energy Company

Board of Directors of the Public Energy Company

The mechanics of setting up the Public Energy Company are fairly straightforward. However, careful consideration will be required to be given to both the terms of the memorandum and articles of association of the Public Energy Company and whom the directors will be to ensure that the correct skillset and appropriate expertise is

available for the delivery of the Project. It is anticipated that the key stakeholders into the Project (the Public Sector investors) will require representation on the Board. Initial appointment is therefore important, as is the mechanics of the Public Energy Company for the removal and appointment of directors.

The directors of the Public Energy Company are responsible for managing the business of the Company on a day-to-day basis within the parameters of their delegated authority. Equity investors into the Public Energy Company will need to understand the differing roles played as a shareholder and investor of the Public Energy Company (which has no obligation to the Public Energy Company – therefore, for example, decisions made by these parties are de-linked from those of the Public Energy Company) and the legal responsibilities of the directors of the Public Energy Company who must at all times act in the best interests of the Public Energy Company.

The Public Sector investors may consider the need for senior officer representation on the board of directors of the Public Energy Company given the statutory obligations of the directors and the relevant need to act in the best interest of the Public Energy Company (and potential reporting requirements to Companies House etc.). The advantage of senior officer representation is that it provides for continuity upon changes in administration and ensures that the business plan of the Public Energy Company continues in the long term. It also helps to mitigate against the risk of conflicts.

External advisers

External Advisers (financial, technical, legal) should be appointed to the Project, and report to their respective engagement managers. During the preparation of the OBC the external advisers assisting the Project Team has been:

- Financial – Grant Thornton UK LLP led by Andy Boak; and
- Technical – Cornwall-Insight Limited led by Ed Reed;

No external legal advice has been sought through the development of the OBC

In the progression of the Project from OBC to commercialisation, these roles will need to be re-procured (and a legal adviser procured) to provide the Project Team the independent advisory support needed to progress through the procurement process and in to deliver of the Public Energy Company.

7.7 Governance of the Public Energy Company

Shareholder/Owner decisions

Certain key strategic decisions of the Public Energy Company may be reserved for determination by the shareholders/owners of the Public Energy Company. Depending on the established commercial structure of the Public Energy Company, this may require the consent and agreement of numerous Local Authority minority shareholders in the Public Energy Company. The level of involvement from Local Authorities who wish to become part owners in the Public Energy Company will have an impact on the Governance of the entity. It has anticipated through the work performed in this OBC that Public Sector parties taking an equity stake will sit at the top of the ownership structure and will be responsible for the key strategic decisions

of the Public Energy Company. The exact form of this is yet to be determined and will require work and formalisation once the consultation process with Local Authorities has been completed. Decisions taken as a shareholder/owner will be taken in its capacity as a Local Authority and are therefore not required to be aligned with the commercial interests of the Public Energy Company.

Matters reserved to the shareholders/partners

It is anticipated that there will be a list of reserved matters sitting outside the day-to-day activities of the Public Energy Company. It is anticipated that these matters would include:

- Altering the strategic objectives of the Public Energy Company;
- Admitting new shareholders/partners, or changing the ownership structure or rights of the Public Energy Company;
- Making a decision to wind up the Public Energy Company;
- Business plan approvals; and
- Committing to finance or procure external finance.

The shareholder/partnership agreement and reserved matters will need to be tested at procurement and agreed among the shareholders/partners.

7.8 Benefits management strategy

The benefits of the Project have been described in the other sections of this Business Case. These benefits, considered in tandem with the key risks identified as inherent in the Project, have been used to analyse the options and arrive at the preferred option.

The key benefits, both monetary and non-monetary will be documented in a benefits management strategy, with a description of the benefit, measurement, key dates, dependencies, risks and the owner. Benefits must be measured regularly and reported on to the Board or Scottish Government. Each benefit will have an owner who is responsible for measuring and reporting on the benefit realisation.

7.9 Regulatory and environmental requirements

The Project Management team will ensure that any regulatory or environmental requirements including permits or licensing are met, should these be required. The necessary requirements can be documented through a 'Register' approach. This will be developed through discussions with:

- Scottish Government
- Local Authorities involved in the Public Energy Company
- Legal, Technical, Financial Advisers
- Other key stakeholders

The register will be maintained and reviewed throughout the Project development process, to ensure requirements are met at the appropriate juncture of Project development.

7.10 Risk management

Key risks have been identified and documented in the Risk Register formed by the OBC Project Team. Each of the key risks of the Project have been assigned potential mitigating actions. Risks should be monitored and updated as appropriate going forward by the established Project Team and Project Manager. This will help to ensure that mitigating actions remain relevant and are being performed to minimise the identified risks.

The Risk Register is attached at Appendix B.

7.11 Conclusion and next steps

The Scottish Government have considered the Project's risks and mitigating actions, the potential benefits and tracking of such, as well as the required practical arrangements to deliver the Project including procurement considerations, services required and Project management arrangements. The Project is expected to be achievable, with a dedicated Project manager and staff input into the Project as well as support from specialist legal, technical and financial advisers, as appointed.

8 Appendix A – Risk Register

Risk Register

The following is intended to serve as a high-level risk assessment of the qualitative issues that could affect the chosen delivery model for the Public Energy Company.

This is not intended to be exhaustive but reflect the risks faced by similar entities as that proposed by Scottish Government.

All risks are closely linked and are mitigated through detailed development planning and (once live) robust operational diligence.

Table 61 - Risk register for the Public Energy Company

Key:

Symbol	Meaning
 <p data-bbox="432 1122 576 1155">Very High</p>	<p data-bbox="970 1122 1393 1155">Very high materially impact</p> <p data-bbox="823 1173 1393 1317">This risk would have a very significant negative impact upon the Public Energy Company and its delivery and all steps should be taken to avoid this.</p>
 <p data-bbox="469 1379 539 1413">High</p>	<p data-bbox="1043 1379 1393 1413">High materially impact</p> <p data-bbox="823 1431 1393 1574">This risk would have a significant negative impact upon the Public Energy Company and its delivery if it materialises.</p>
 <p data-bbox="443 1637 564 1671">Medium</p>	<p data-bbox="995 1637 1393 1671">Medium materially impact</p> <p data-bbox="847 1688 1393 1722">This risk would have a medium impact</p>
 <p data-bbox="469 1783 539 1816">Low</p>	<p data-bbox="1051 1783 1393 1816">Low materially impact</p> <p data-bbox="842 1834 1393 1977">This risk is deemed to have a limited impact on the Public Energy Company due to low financial impacts or ease of mitigation</p>

	Very High	Very high likelihood of risk materialising The likelihood of this risk materialising is very high during the project
	High	High likelihood of risk materialising This risk has a high likelihood of occurring
	Medium	Medium likelihood of risk materialising This risk has a medium likelihood of materialising during the project and activities of the Public Energy Company
	Low	Low likelihood of risk materialising There is little risk of this event occurring

Risk	Cause	Materiality/ Impact	Likelihood	Mitigation
Failure to establish requirements of White Label partner in a prompt and timely manner	<ul style="list-style-type: none"> Delays in agreeing tender specification and/or governmental entity that will be contracting entity 	 Very High	 Low	<ul style="list-style-type: none"> Initial scoping of requirements has already been undertaken as part of Scottish Government policy statements, SOC and public engagement events Continued engagement with Local Authorities to ensure expectations of potential stakeholders in the Public Energy Company are met, while focusing upon March 2021 deadline
Inability to successfully choose a White Label partner in a prompt and timely manner compliant with public procurement regulations	<ul style="list-style-type: none"> Lack of viable tender responses from potential White Label partners Delays in evaluating 	 Very High	 Low	<ul style="list-style-type: none"> Detailed tender specification can be developed based upon Scottish Government's requirements and using information from comparable exercises undertaken by other Local Authorities It is assumed that a contracting organisation of the scale and scope of the

	<p>tender responses</p> <ul style="list-style-type: none"> • Breach of public procurement regulations due to non-compliant tender 			<p>Scottish Government, and the profile associated with being “Scotland’s energy supplier” will yield high levels of interest</p> <ul style="list-style-type: none"> • Experienced personnel to be assigned to project to ensure prompt and effective evaluation of responses from potential White Label partners. • On the assumption of a minimum three-month timescale for a full tender exercise to obtain a White Label partner, the current deadline of March 2021 is attainable, and may indeed allow for an initial unsuccessful tender run should such a situation arise • For example, Norwich City Council undertook an unsuccessful tender for a White Label partner in early 2018 before re-issuing documentation in June 2018 and awarding the contract to Engie
Inadequate planning and development	<ul style="list-style-type: none"> • Insufficient resourcing levels (personnel, experience, systems, time) made available to develop the White Label by central and/or local government • Insufficient focus at central and/or local government level 	 <p>Very High</p>	 <p>Low</p>	<ul style="list-style-type: none"> • Detailed business case that identifies all known costs and best view of likely revenues over a long-term, e.g. initial five years with growth projections and thereafter steady state revenue • Longer-term objectives for the Public Energy Company have already been stated by Scottish Government, which should evolve to reflect customer demands, industry/sector developments and stakeholder requirements • From a personnel perspective, the Public Energy Company will need suitably skilled resource • This is over and above operational requirements

				associated with marketing and communications, systems and stakeholder engagement, and wider legal issues, e.g. ensuring State Aid compliance
Local Authorities may have concerns about participating given their own policies and targets, and therefore the depth of interest is unknown	<ul style="list-style-type: none"> • Lack of knowledge and/or awareness of the Public Energy Company and its potential benefits • Existing local-centric policies or schemes that may be incompatible (operationally or financially) with the Public Energy Company 	 <p>Very High</p>	 <p>High</p>	<ul style="list-style-type: none"> • Public engagement events have already been undertaken to examine potential interest from Local Authorities, in addition to ad hoc conversations and policy statements from Scottish Government • These can be expanded upon and formalised as a means by which to promote transparency as to the operation of the Public Energy Company and its objectives, and how these can be integrated with local initiatives and other policies • The Scottish Government should, however, expect that some Local Authorities may be unwilling or unable to participate in the Public Energy Company due to their own schemes, e.g. the council-backed Aberdeen Heat & Power, Hebrides Energy
Potential participants may have concerns about leaving legacy relationships, which may discourage them from joining	<ul style="list-style-type: none"> • Existing contractual relationships and/or long-term contractual structures for procurement • Concern regarding legality of and/or compliance 	 <p>Very High</p>	 <p>Medium</p>	<ul style="list-style-type: none"> • Common elements and approach between old and new methods of energy procurement and supply would be expected, and the Public Energy Company should communicate this as part of its wider engagement plan with potential members • Communication of compliance and compatibility with existing approaches, i.e. the Public Energy Company is not mutually exclusive

	associated with the Public Energy Company			<p>with other delivery approaches for energy</p> <ul style="list-style-type: none"> • Communicate that participation at project inception is not essential and that local authorities can join at a later date
Insufficient project management and programme oversight	<ul style="list-style-type: none"> • Insufficient resourcing levels (personnel, experience, systems, time) to establish, operate and manage the Public Energy Company and its (key) relationships • Failure to devote adequate commercial and legal resource to the project 	 <p>Very High</p>	 <p>Low</p>	<ul style="list-style-type: none"> • Establish clear lines of responsibility and reporting at outset • Creation of well-resourced Project team with access to external advice/expertise (market, legal, regulatory) as required • Create timeline for Project with critical paths and defined “go/no go” milestones which links back to detailed business case
Unclear/complex governance structure	<ul style="list-style-type: none"> • Absence of a clear organisational and management structure, SoDA etc. • Absence of a suitably 	 <p>Very High</p>	 <p>Medium</p>	<ul style="list-style-type: none"> • Establish at the outset a workable governance model that ensures clear delineation of responsibility for the Public Energy Company and stakeholders • Ensure that the structure of the Public Energy Company is flexible enough to allow for

	<p>flexible management and governance structure</p> <ul style="list-style-type: none"> • Failure to devote adequate commercial and legal resource to the project 			<p>changes in the ownership model over time</p> <ul style="list-style-type: none"> • Sufficient legal resource to put in place governance structure and form company – including opening company bank account, access to line of credit/collateral, etc. • Describe KPIs/reporting requirements for company/board/management
<p>Risks of diseconomies of scale as Local Authority participation grows</p>	<ul style="list-style-type: none"> • Failure to commit adequate resources (financial, systems, personnel) to the Public Energy Company and its management and operation as its customer base and/or number of participating local authorities 	 <p>High</p>	 <p>Medium</p>	<ul style="list-style-type: none"> • While economies of scale from the activities of the Public Energy Company are apparent, there is also a risk of diseconomies of scale should the scale of the membership and its activities grow too quickly or be inefficiently managed • While not wishing to discourage or dissuade new participants, Scottish Government must ensure that growth is carefully managed in line with agreed, transparent criteria • Furthermore, while the Public Energy Company will remain open to all Local Authorities, new stakeholders must also be chosen based upon transparent and auditable criteria and an expectation that they share the aspirations and goals of Public Energy Company and its existing stakeholders

<p>Loss of customers upon expiration of the White Label agreement</p>	<ul style="list-style-type: none"> • Under industry rules, White Label Suppliers do not own their customers – instead, these are registered to the Fully Licensed partner • This means that if the contractual arrangement between the Public Energy Company and its partner were to end, the Public Energy Company would lose its customers unless action were taken to retain them 	 <p>High</p>	 <p>Medium</p>	<ul style="list-style-type: none"> • The Public Energy Company could look to contractually secure its right to its customers through either securing the right to purchase its customers upon moving partner supplier, or through an exclusive contact and marketing rights to its customers to help persuade them to switch with it
<p>Significant change to retail or wholesale market environment</p>	<ul style="list-style-type: none"> • Unexpected and material shift in regulatory and/or 			<ul style="list-style-type: none"> • Detailed business case developed with prudent view of all known costs and reputable forecast of future trajectory

	<p>legislative structure of the industry</p> <ul style="list-style-type: none"> • “Black Swan” event affecting the retail and/or wholesale market(s) 	Medium	Medium	<ul style="list-style-type: none"> • Use of external advisers to sense check business case and provide independent view of market and regulatory developments • Inclusion of contingency fund to accommodate any unforeseen changes
<p>Actions of Public Energy Company and/or White Label partner could negatively impact upon public perceptions or reputation of Scottish Government and other stakeholders (and vice versa)</p>	<ul style="list-style-type: none"> • It is not certain that the Public Energy Company’s tariff(s) will always be among the most competitive • Poor customer service • Public Energy Company fails to meet primary objectives • Adverse press coverage of the Public Energy Company 	 Low	 Low	<ul style="list-style-type: none"> • Risk associated with non-compliance with industry rules technically falls on the partner supplier in White Label supply, but we would expect the Public Energy Company to have strict compliance controls to protect itself • For example, traditional arrangements have prevented the White Label partner from carrying out face-to-face marketing, this being the responsibility of – in this instance – the Public Energy Company • A suitably robust Service Level Agreement (SLA) with agreed metrics and penalties for non-compliance could be used to mitigate this risk
<p>License/rule changes</p>	<ul style="list-style-type: none"> • Industry rules and licences are “living document 	 	 	<ul style="list-style-type: none"> • Take third-party reporting service on regulation developments to highlight where change may be

	<p>s” and subject to change.</p> <ul style="list-style-type: none"> For example, Ofgem is currently reviewing the supply licences to move to a “Principles Based Regulation” framework – plan for robust, but flexible, systems to monitor and report on compliance 	Low	High	<p>required to the Public Energy Company’s plans</p> <ul style="list-style-type: none"> Smaller suppliers are typically more nimble at adapting to regulatory change Include a contingency budget to accommodate inevitable rule (and as a consequence process/ resource) change
Operational failure/shortcoming once live	<ul style="list-style-type: none"> Insufficient resourcing levels (personnel, experience, systems, time) made available to operate the White Label by central and/or local government 	 Low	 Low	<ul style="list-style-type: none"> Clear and detailed Target Operating Model (TOM) from inception to market entry (domestic), expansion of offering (energy-as-a-service), expansion of target customer base (non-domestic) and transition to Fully Licensed Supply

	<ul style="list-style-type: none"> • Systems failure • Breakdown of relationship with White Label partner 			
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Source: Cornwall Insight

Risk Register ownership and operation

During the set-up phase industry and legal specialists will be required to assist with negotiating contracts and services, translating a business plan into a Target Operating Model, developing strategies for trading and pricing, marketing and public engagement and wider social initiatives.

The commercial and reputational risks and their mitigation would need to be a core element of the creation of the Public Energy Company. We recommend that each stage of the company's development has a Risk Register that identifies:

- All risks (including assumptions)
- Assigns each an impact and probability rating
- Where the risk impacts on other work streams
- Action to mitigate the risk
- Tracking of when the risk was last regraded

The Risk Register would be maintained by an appropriate person/team at the different stages of the Project and be reported to the relevant executive powers to monitor the risks and approve mitigation actions as necessary. The table below suggests the owner and executive for the Risk Register.

Table 62 – Risk owners and executives

Project phase	Risk Register owner	Executive
Planning/development	<ul style="list-style-type: none"> • Business development manager • Link to Target Operating Model • Sponsor Finance Director (or equivalent) • Company incorporation/governance work stream, business model/ plan, external advisers, recruitment 	<ul style="list-style-type: none"> • The Scottish Government sponsor • Establish required reporting metrics • Focus on go/no-go risks and mitigation • Set long-term strategy, but focus on short term (e.g. establishment of Public Energy Company)

Market entry/go-live	<ul style="list-style-type: none"> • Energy company executive • Link to Target Operating Model, executive roles (e.g. operations, finance, counterparty contract management etc.) as required, marketing and engagement plan (stakeholder and customer), compliance team 	<ul style="list-style-type: none"> • Stakeholder board • Establish required reporting metrics • Focus on operational process, customer contract/regulation/legislation compliance, and latest market growth/revenue forecasts and costs
Operational phase/ full market entry	<ul style="list-style-type: none"> • Ops/Finance director (or equivalent) • Link to operations model, finance reporting, customer services, counterparty contract management/SLAs/KPIs, market/regulation monitoring 	<ul style="list-style-type: none"> • Stakeholder board • Establish required reporting metrics • Focus on operational process, customer contract/regulation compliance, market position, policy and regulation changes, and latest market growth/revenue forecasts and costs

Source: Cornwall Insight analysis

9 Appendix B – Outcomes of stakeholder engagement events

Stakeholder Event One - 27th November 2018

On 27th November, the OBC team and Scottish Government hosted a workshop event with Local Authorities from across Scotland to discuss key issues associated with the development of an OBC for a Public Energy Company for Scotland. The agenda for the event was as follows:

10:30 - Arrival, tea & coffee
10:45 - Neil Ritchie, The Scottish Government
11:00 - Michael Berrington, Grant Thornton
11:15 - Tom MacLennan, Aberdeen City Council
11:30 - Morning Discussions

What do communities want, or need?

- What do you believe are the main issues facing communities regarding energy supply?
- How can these needs be reflected in what the public energy company provides?
- How will reflecting these requirements meet our objectives of tackling fuel poverty/economic development/carbon reduction?

An innovative energy company

- What other innovative energy business models have you thought or heard of?
- Which of the suggestions seem most deliverable, not just now but in a few years' time?
- How will these best deliver for fuel poor households in your area?

13:00 - Lunch
13:45 – Afternoon Discussions

White Label supply

- What can we achieve through a White Label supplier?
- What are the pros and cons of national contracts versus local contracts?
- What criteria are important in choosing a White Label supplier? (Price? Provision of social obligations? Renewable percentage?)

How to move forward?

- What barriers are there to you setting up an energy supplier?
- How do you see your role in the process of delivery and what support might you need?
- What is our role in future generation and heat networks?

15:15 - Next steps

15:25 – Closing

What do communities want, or need?

The below explores the issues faced and the suggested ways in which these needs can be reflected in what the public energy company provides.

Fuel Poverty and the cost of energy

- Some attendees believed that the question regarding needs vis a vis energy supply should be reframed as the issue is not about supply but rather price. Essentially, it's all about price in tackling fuel poverty. There were discussions later in the day surrounding who was in fuel poverty in Scotland. It was suggested that there is, perhaps, disproportionate focus on social housing when those living in the Private Rented Sector (PRS) or owner occupiers are more likely to find themselves in fuel poverty. Whilst social housing may provide a 'low hanging fruit' in that properties are easy to access and it's often easier to roll out schemes to social housing, it's paramount that the OBC recognises the diversity of households that find themselves in fuel poverty.
- Following on from the discussion on price, it was suggested that the Public Company Energy could allow multiple pricing structures – communities will not necessarily expect equality of pricing, hence multiple tariffs should be explored in the OBC. Attendees suggested an increasing block tariff model– high users pay more per unit after a certain set limit (this would mean high users subsidise others.) Price could be reduced/increased depending on demographics (like a progressive taxation) – e.g. a social housing tenant would pay less, and private companies pay more.
- Prices could increase with increased electricity usage, for instance if you had a swimming pool/ a large house you would pay more for your electricity. This would further deter people from excessive energy usage, incentivising efficiency, sub sequentially, reducing emissions.
- It was suggested that when creating a Public Energy Company, the role of standing charges should be considered – for many this is the bit that 'hurts' regarding energy pricing. Some delegates explicitly stated that the standing charge needs to be scrapped.
- The question was posed as to whether the Public Energy Company could avoid ECO obligations. By losing this 'add on' cost, then the unit cost could be brought down. Do questions regarding fair competition then arise?
- The majority of attendees believed that, in order for uptake to be successful, the Public Energy Company must offer the cheapest tariff for fuel poor households. Whilst price is clearly important, others stated that if, for whatever reason the Public Energy Company is not the cheapest, then the superior quality of the PEC must really be highlighted to prospective consumers. Many discussions centred

on how the price of energy can be kept low under the Public Energy Company – concerns were raised about the ability to drop price when buying from a White Label.

- Delegates asserted that the Public Energy Company should be not-for-profit and all surplus should be reinvested.
- Regarding price the price of gas vs electric also came up in conversation as a consideration in the Public Energy Company. Consumers will not switch energy source if the counterfactual source is substantially cheaper.

Quality service and advice

- One of the barriers to switching to the Public Energy Company is customer inertia. Consequentially, switching needs to be easy and accessible; ignorance, lethargy and mis selling were all cited as reasons consumers do not ‘shop around’ and switch.
- There was support in the room for the Public Energy Company to provide genuine, independent advice on energy saving and energy tariffs. This is something that the Local Authorities are already doing through their advocacy model whereby local advocates go out and provide energy advice to householders. Renfrewshire currently has 4 advocates who go out to all residents to give advice, other places have advice shops which people can attend. Many delegates believe that the provision of independent advice alongside the Public Energy Company is intrinsic to it being a trusted and successful entity. In addition, it’s important that customer service, and how this is managed is considered as the quality of customer service underpins how an energy supplier is perceived.

Renewables and supply

- Attendees discussed the increasing interest in renewable energy amongst the general populace. Given young people’s interest in the environment and sustainability, it was suggested that the ‘green’ nature of energy supply will be more important to the homeowners of tomorrow than the price.
- Despite having an interest in renewables, many communities lack the knowledge of how to generate their own energy so there needs to be support with regards to that.
- Delegates advocated purchase of local low carbon electricity generation as part of the value proposition for the Public Energy Company. Local generation brings with it a myriad of perceived benefits including local jobs. *“We have opportunity to generate energy in different ways across different parts of Scotland – it could become a world leader in being carbon neutral country.”*

Infrastructure

- Infrastructure remains another issue, especially given the large proportion of households in Scotland that are off gas grid.
- It was highlighted that connecting local generation to the network can be expensive, and developers want to plug in and go and there is not always the infrastructure or resources for this. Many delegates stressed that DNOs need to be better equipped to pick up decentralized energy production

The main issues facing communities were identified as: fuel poverty, carbon reduction, unit cost, security of supply, switching (associated difficulties). Some delegates expressed the opinion that it is difficult to see how a White Label can deliver what is required. A further suggestion is that there needs to be a unique selling point of the Public Energy Company – perhaps it is that any profit would be reinvested locally?

2. An innovative energy company

In addition to the examples provided to delegates, some innovative energy business models outlined were:

- a) energy as a service,
- b) the subsidised tariff model,
- c) bespoke tariffs,
- d) collective switching,
- e) aligning with EV roll out (energy storage),
- f) smart appliances,
- g) higher tariffs to help fund energy projects, and
- h) a model focused entirely on local authority tenants.

The deliverability of various models was assessed, a few of these assessments are included below

Name of business model: Energy as a service

Scoring Criteria	Positive	Neutral	Negative
Set up cost		I	I
Price for consumers		II	
Complexity	I		I
Sustainability		I	I
Contribution to Fuel Poverty	I	I	

N.B: Price for consumers would be skewed under this model and the model would have to be made as simple as possible for customers.

Name of business model: Reduced/subsidised bill for fuel poor

Scoring Criteria	Positive	Neutral	Negative
Set up cost			II
Price for consumers		II	
Complexity			II
Sustainability			II
Contribution to Fuel Poverty	II		

Based on the deliverability matrix, the following models/ideas were perceived to be the most 'deliverable' by attendees:

- Aligning with EV roll out
- multi tariffs (whereby the more well off you are the more you pay for your energy)
- focusing on local authority tenants/social housing.

- In terms of EV integration, it was specified that electricity from vehicles would be sold back to the grid. Attendees discussed how developments would need to have a minimum requirement re number of EV charging spaces if we were to see wide scale deployment of electric vehicles and the subsequent EV integration model outlined.
- Under the local authority housing model, void properties would have to be steered towards the Public Energy Company by all 32 local authorities. However, there were concerns raised that social housing would be used for 'easy profit' or as a sort of 'guinea pig'. There was also concern that LAs would lose the c£80 per property they currently receive from energy companies for "void switching".
- Attendees stressed that it is worth noting that a higher tariff for certain demographics would need to be sold in the right way as it is a hard sell.
- Proposals to include smart appliances in terms of 'smart grids; - storage provision were caveated with the face that this would be difficult to utilise in rural areas.
- One group of delegates promised a new business model whereby there would be a fixed price (energy as service) for those in fuel poverty, but simple variable pricing for others. Defining the boundaries re fuel poverty would be important here and they recognised that some would benefit from this model, whilst others wouldn't so much.
- The merits of smart meters were discussed in relation to the model which focuses on Local Authority tenants/social housing as they can help advocacy and encourage efficient energy usage. Delays in the smart meter rollout would therefore undermine the deliverability of this model at present.
- Using excess wind/solar to provide free hot water storage could be explored as a potential model.
- Business tariffs could be used to help subsidise fuel poverty – this could be put into lease contracts.

3. White Label Supply

What can we achieve through a White Label supply?

- A national approach could provide necessary scale to get a White Label deal.
- Income could provide a revenue stream for energy efficiency work.
- Connection with citizens
- Delivering policy objectives
- Encourage switching – a branded offer helps this.
- Reduced risk vs alternatives
- Benefitting from expertise
- Economies of scale
- Marketing power
- Encourage people to get off a standard variable tariff.
- Potential to get the best value
- Extra competition in the market – comp goes up, prices go down

- Different set of social and ethical objectives.

Barriers to White Label supply and considerations

- Is the social focus going to put off some potential suppliers?
- Will terms of White Label be affected by number of projected customers?
- Considering the impact on White Label suppliers resources if they have a sudden influx of new customers as a new supplier.
- Looking at local authorities' voids will give us a quick idea of initial take up of the Public Energy Company.
- Population density (very asymmetric) serves as a blocker to getting a White Label but a bigger public sector tender may help this.
- A proposal was made to split the country in terms of its needs and have several different White Labels. It could be split regionally, for example North, West, East, South or by community characteristic.

Pros and cons of local and national White Label supply

	Advantages	Disadvantages
Local	<ul style="list-style-type: none"> • High levels of trust in local brand. LA may be viewed as apolitical, which could be beneficial. • Ability of (some) local authorities to generate customer numbers is good. • Can utilise local generation. • Potentially more opportunities for face to face advice and support. • More reactive to, and understanding of, local needs. • Flexibility to tailor offer. • There are already the existing communication channels in place (Local Authority housing offices, press etc.) 	<ul style="list-style-type: none"> • Reputational risk, especially given that LAs have little influence over the White Label Supplier. • Unattractive off to the market due to the low number of potential customers. • Capacity and skills within Local Authorities may not exist. • Reduced buying or negotiating power. • Cost replication x 32. • 32 inconsistent brands could emerge.

	<ul style="list-style-type: none"> • Local contracts = local community benefits through procurement. • Tariffs can be tailored to local needs (for example, rural tariffs were one suggestion) • Opportunities to link with local renewables. 	
National	<ul style="list-style-type: none"> • Reduces duplicated effort. • Consistency between the 32 Local Authorities. • Larger pool of available customers. • Increased volumes would result in improved tariffs. • Single infrastructure, centrally shared services. • Economies of scale – lower costs would allow the Public Energy Company to be more competitive. • More buying power. • Scottish brand may be received positively. • Risk averse Local Authorities may be more likely to participate. 	<ul style="list-style-type: none"> • Lack of autonomy for Local Authorities and it would be difficult for the White Label to be flexible enough to meet the needs of 32 Local Authorities. This is coupled with a lack of understanding of regional difficulties/specificities. • Loss of local branding which some people may prefer to National/Scottish branding. • Speed to market could be slower as it would be a larger project, hence more complex and time consuming to get agreed and set up.

Criteria to consider when choosing a White Label supplier:

- Customer service
- Alignment with local authority values
- Price

The top three above were considered the most significant.

- Provision of social obligations
- X% of energy delivered by renewables.
- Tariff solutions for local need/demand
- Ability to sell locally generated energy
- Sustainability
- Trustpilot rating
- Call waiting times
- Perception of White Label supplier
- Community fund
- Advocacy
- Low risk
- Carbon reduction
- Not for profit
- More responsible re carbon footprint
- Marketing ability (LA's have limited marketing budgets)
- Balance sheets (risk perspective, don't want them to fold)

4. How to move forward?

Some key barriers or challenges local authorities face moving forward are:

- A lack of resources (especially financial) – one delegate cited huge departmental and cross council cuts.
- A lack of commercial expertise and internal support.
- The challenge of negotiation for a White Label, and the challenges associated with interpreting procurement.
- Timescales – the time it will take to get ready for procurement.
- Marketing budgets are extremely tight (or non-existent)
- Some members will need to be convinced – they may perceive this to be a political risk. The Public Energy Company needs to be presented as an opportunity for members.
- Concerns surrounding legal fees.
- Unsure of where to assign resources on this project.

Support required/ suggestions made:

1. National coordination/ ALEO helps get over resource issue but needs to be big enough to service 32 LAs.
2. Delegates stressed the importance of involvement in the OBC process and opportunities to feed in and feed back to process.
3. Scottish Government talking to the chief executives/COSLA to make CEs more aware. Many delegates were concerned that the CEs, despite receiving the letter from Scottish Government, were unaware of the Public Energy Company plans.
4. Attendees stated they would like more information on how much this will cost Local Authorities. They felt that they couldn't fully support or back proposals without a knowledge of costs.
5. Scottish Government must commit to resourcing or signal the level of support they will be providing.

6. Attendees stressed that two specific areas they needed support in were legal and procurement.
7. Support may be required in the day to day coordination of the Public Energy Company.
8. A discussion needs to occur surrounding how the Public Energy Company will coordinate with other existing policies.
9. Local Authority representatives requested that they be provided with ring fenced marketing budgets to promote the Public Energy Company.
10. A further suggestion was that the local authorities need to share what they want and need and be more explicit about what they would and wouldn't accept in terms of the Public Energy Company.
11. Some delegates suggested that support from other local authorities was needed alongside the support from Scottish Government. Knowing what other local authorities are up to, sharing best practice, and having central data capture would all prove really useful in this respect.

Overall, there was a lack of consensus when it came to ascertaining what the local authority role in the Public Energy Company would be. Consequentially, the OBC needs to clarify this. Some delegates saw the role as predominantly promotion, getting people to sign up, voids, leases, and initial steering. Some anticipated that once the Public Energy Company was properly set up and had a customer base, they wouldn't play much of a role.

Most delegates believe that the role played by the local authorities will depend on the delivery model.

District heating and future generation of heat

"There is so much interest in renewables and energy generation in Scotland that to exclude it would miss the point and alienate local authorities."

- Attendees were largely supportive of utilising the Public Energy Company as an opportunity to explore district heating and the future generation of heat further and recognised that these considerations should form part of the OBC. Nevertheless, it was suggested that Scottish Government shouldn't 'walk before you run' and it is paramount that the OBC focuses on fuel poverty and energy efficiency in the first instance.
- With regards to district heat networks it was suggested that there should be a centralised pot of funding, and there is a need for the district heating energy company to coordinate with a public energy supplier. Some attendees posed the question as to whether or not the Public Energy Company can become the national body for district heat. At present, many believe that there is not enough incentive to developers from Scottish Government to pursue District Heat – remedying that could be part of the Public Energy Company's role.
- Another proposal made by attendees was the introduction of Local Feed in Tariffs (FiTs) to support the deployment of renewables. It was suggested that the Scottish Government attempt to replicate FiTs even if Westminster drop them/when they drop them.
- Further, it was suggested that PPAs could be set up with local generation projects in order to support them.
- In terms of building future generation of heat into the OBC, attendees recommending thinking about timescales for green energy production and

considering how the length of White Label procurement will fit in with the growth of generation.

Miscellaneous considerations

- Has there been the opportunity for the Big 6 to comment on plans?
- How does the Public Energy Company fit in with SMETS2?
- How can proposals be tied in with housing more generally in terms of energy efficiency measures?
- Are there discussions with the NHS vis a vis benefits to health posed by fuel poverty reduction? Could certain tariffs be prescribed?

Attendee list:

Jamie Macleod, Scottish Government	Craig Doogan, Renfrewshire
Neil Ritchie, Scottish Government	Douglas Evans, Falkirk
Alan Clark, Scottish Government	Anne Ferguson, Stirling
Michael Berrington, Grant Thornton	Jim McAloon, West Dunbarton
Neil Peckett, Grant Thornton	Tom MacLennan, Aberdeen
James Higgins, Ecuity	Ann M Murray, Comhairle nan Eilean Siar
Alex Jones, Ecuity	Alan Paul, Fife
Ijaz Bashir, South Ayrshire	Lorna Pearce, Argyll and Bute
Andrew Brocket, North Ayrshire	Caroline Rodgers, East Lothian
Mark Cassidy, Perth and Kinross	Peter Rogers, West Lothian
Ian Doctor, Clackmannanshire	Duncan Smith, Renfrewshire
Roz Smith, Stirling	Lynda Stevenson, North Lanarkshire
Andrew Tweedie, East Renfrewshire	

Stakeholder Event Two - 16th January 2019

On 16th January 2019, the OBC team (comprised of Ecuity, Grant Thornton and Cornwall Insight) and Scottish Government hosted a workshop event with a range of stakeholders from various sectors to discuss key issues associated with the development of an OBC for a Public Energy Company for Scotland.

The agenda for the event was as follows:

10:30 - Arrival, tea & coffee

Presentations (slides available - no minutes taken)

10:45 - Neil Ritchie, The Scottish Government

11:00 - Michael Berrington, Grant Thornton

11:15 - Ann McKenzie, The Scottish Government

13:30 – Adam Boorman, Cornwall Insight

Discussions (minutes below)

11:30 - Morning Discussions

- What do communities want, or need?
- Driving Innovation

13:00 - Lunch

13.45 - Afternoon Discussions

- White Label supply
- How to move forward?

15:00 - Next steps

1. Introductions

At the start of the event there was some discussion on the role of local authorities in the public energy company and potential candidates for the White Label supplier. Attendees were updated on local authority engagement including high level outcomes from the November local authority engagement event. Preferred terms for procuring a White Label supplier are in development through these engagement events as well as through further research. It was agreed there is scope to conduct further stakeholder engagement on this.

2. What do communities want, or need?

Set out below is a write up of attendee's views and ideas regarding the issues faced by communities/ consumers and the suggested ways in which these needs could be reflected in what the public energy company provides.

Trust

- People want to trust their Local Authorities but there are concerns that they lack expertise. It's worth noting that some local authorities have taken a long time to get moving on a public energy company for their cities.

- There are surveys that show that, typically, public services are more trusted in Scotland. Related to this, Robin Hood energy saved money at launch as publicity was free due to the association with the Local Authority.

Price

- Consumers care most about price. Second to this is security of supply. Robin Hood's cheapest bill is over £1,000. How are you going to compete with Octopus who are cheapest on the market? Scotland has the lowest switching rate across the UK. 8 of the 10 lowest parliamentary constituencies for switching are in Scotland.
- The challenge is whether they will be able to provide cheaper energy than the counterfactual. Provided people are switching from an SVT they will be making savings.
- It is not necessarily that the energy company has to be the lowest price, which is often set at an unsustainable level. Those who are paying high prices can still save significantly by switching to a more reasonably priced deal. It's partly about engaging with the least engaged people and serving those that are not served by the market currently. There is recognition that it is unlikely that the energy company will have very cheapest bills on the market.
- Important to ensure that Local Authorities don't lump cost (such as the cost of set up) onto bills. We should be talking about clients not customers, because what they need (as opposed to just energy supply) is healthy, warm, comfortable homes. It's not the failure of householders to engage with the market, but the failure of market to gain the trust of householders.
- Supplying energy is not a wonderful business to be in as margins are low, what really is the expectation about what a national company can do which couldn't already be done locally? Consumers want prices that are fairer over time and allow them to budget. Price stability at a reasonable level over time.
- Worth noting that the price cap does provide some price stability. However, the regulator is considering rising prices now. Nevertheless, paying for energy by direct debit provides budgeting stabilities.
- It's vital that we do not just look at price point – it's worth considering how a public energy company can help across all the drivers of fuel poverty. Longer term, how can it help communities generating energy. How can the Public Energy Company assist with innovative options for supplying energy and energy efficiency at the same time – warmth as a service for example?

Type of business (if a White Label Supply)

- One of the things a lot of communities want are socially conscious and environmental businesses. Different ownership models and community having a wider influence are of interest. Community purpose is desirable. In the highlands people pay a higher cost for their energy so this is something that needs to be considered.

Ecuity addition: Surplus in the highlands - the region pays the highest bills in GB because of a regional system for distribution costs. More on this can be found [here](#).

- Many areas in Scotland have abundant renewable energy, the White Label Supplier should seek to capitalize on this. In addition, existing local energy projects should be integrated, where possible.

Customer service

- Customer service is very important. Citizens Advice deals with 30,000 energy issues a year in Scotland with issues around billing & metering. Most of the companies which have gone bust have terrible customer service records. If looking at tendering a White Label Supplier, you need to prioritize customer service.
- Good customer service – services that are available from a call centre or face to face interaction are particularly important for older people (it is important that the Public Energy Company or its White Label supplier is not an entirely digitalized customer service) New Scottish Social Security Agency perhaps provides a model there. In terms of the support for vulnerable customers, the Public Energy Company must ensure it provides, at the very least, the same level offered by existing suppliers such as Warm Home Discount. People would benefit from a 'one stop shop' where they can find out information on the Public Energy Company, get debt advice and health, and find out what initiatives they are eligible for.
- 68% of client journeys involve some form of face to face interactions – a large number of these involve demonstrations, such as central heating demonstrations. (so it's important this is provided by either the Public Energy Company or the White Label Supplier) Citizens Advice and Glasgow social housing do a more holistic way – drawing on this, we are calling for a National Energy Service.
- Decent levels of uptake are essential to delivering any of the objectives of the Public Energy Company, this links into the customer service point. In order for people to benefit, it has to be trusted and something people want to sign up to. Regarding this, the Public Energy Company must avoid the frequent assumption by politicians that government (or anything associated with the Government) will be trusted, as research shows governments are tarred/mistrusted in the energy sector as anyone else. Consequentially, there may be perception issues.
- Could the Public Energy Company provide a longer-term price guarantee to community energy generators? Or could there be the potential for aggregating demand for grid services to smaller players? Although, not sure how practical with a White Label agreement. Concerned that continuity of price may be under threat with the advent of smart meters and time of use tariffs - how could we ensure that time of use is wholly beneficial?
- The work that must go into acquiring customers is actually really challenging. Our power tried to raise additional funding but have been unable to repay a

bond due to lack of growth in market. How will a Public Energy Company be able to grow the market?

- It was suggested that if the Public Energy Company really wants to tackle prices, they might need to consider owning the network. *“Taking £100 off someone’s bill won’t solve fuel poverty.”*
- It’s worth remembering that direct debit customers are not the most vulnerable, pay as you go (pre-payment meter) customers are. Ultimately, pay as you go customers shouldn’t pay more. **One proposal is that people who use lots could pay more (this could be in the form of rising block tariffs.)** However, some attendees disagreed with rising block tariffs as these can punish those who, for whatever reason, must use more energy than others. For instance, the unemployed who are at home more, those with small children, those who are ill or disabled who may have to heat their homes to a higher temperature or may have specialist equipment with a high energy demand.
- We need to improve connectedness between local communities and local generation. Would it be possible to remove the Public Energy Company customers from network charges? Virtual local network project in Mull is a good idea – SSE Networks have made it available more widely. New generation can go onto constrained network if there is new demand.
- Public Energy Company should not be framed around retail supply but should be framed around supporting overall objectives of energy policy – for example decarbonisation. Public Energy Company will not be allowed to get away with a narrow scope, and Scottish Government need to be bold and mustn’t define itself narrowly. Additionally, the Public Energy Company (and Scottish Government) shouldn’t be afraid to spend public money on achieving public sector objectives.
- One attendee believed that the summary of community needs was a massive red flag as climate change mitigation versus fuel poverty is a huge policy issue (the two agendas are in conflict with one another and cannot be solved simultaneously) Believes Public Energy Company should decarbonise heat supply and should not aim to tackle fuel poverty.

Top five community needs

1. Low Price, but sustainability of price over time may be more important than absolute lowest in market
2. Customer service is high – not just being digital
3. Environmental objectives are being supported
4. Reservoir of expertise/catalyst role for the Public Energy Company with LAs and Communities
5. Support for fuel poor households.

3. An innovative energy company

Some innovative energy business models proposed to delegates were:

a) Energy as a Service,

Energy as a Service does away with charging customers for how much energy they use, focusing instead on how they use energy. Rather than paying for the number of kilowatt hours you consume, you will instead select a tariff such as 'Comfort' where you could pay a monthly subscription at a competitive fixed price rather than a cost per kilowatt hour. Just like mobile phone companies moved from charging for calls per minute or text to an overall monthly all-inclusive service offering, the same is possible for the energy sector.

b) The Subsidised Tariff Model,

Certain customers would pay higher tariffs to subsidise fuel poor households, meaning they pay less.

c) Bespoke Tariffs,

This entails there being different tariffs for those that fall under different criteria.

d) Collective Switching,

Collective switching is where customers negotiate a group deal with a utility service such as gas or electricity. In this instance, this would mean groups/communities switching to the Public Energy Company as their provider en mass.

e) Aligning with EV roll out (energy storage),

The roll out of electric vehicles could provide the opportunity for 'mobile power storage.' Vehicle to grid technology would allow for energy stored in electric vehicles to be fed back into the national electricity network.

f) Smart Appliances,

Using smart meters and appliances to control energy usage.

g) Higher tariffs to help fund energy projects, and

This would involve tariffs being slightly higher but any profit being invested in local energy projects, especially those pertaining

h) A model focused entirely on local authority tenants.

Using local authorities as the gatekeeper, this model would mean that, at least initially, the Public Energy Company was pitched to local authority tenants solely.

The deliverability of various models was assessed using the deliverability matrix that we utilised at the Local Authority engagement event. Generally, there was not consensus on the usefulness of the matrix and there were concerns about using the findings quantitatively. Considering this, below are some comments from the matrix forms, and wider conversation surrounding the deliverability of various models and

what innovative ideas the Public Energy Company could include. It is worth noting that attendees commented that these models are not mutually exclusive (many of them can be included in parallel within the Public Energy Company) Also, it was commented that the up costs for any of these models would be the same.

- **Aligning with EV roll out**
 - EV owners tend to be wealthy so this does not align with fuel poverty aims of Public Energy Company as those in fuel poverty are very unlikely to own electric vehicles.
 - This could encourage EV uptake.
 - There is not a clear strategy for rolling out EVs. The DNOs do not want people going off-grid. Not sure the Public Energy Company should be playing a role in it.

- **Higher tariffs to help fund energy projects**
 - If this causes wholesale price to come down, or results in a local supply tariff then the contribution to fuel poverty could be positive.
 - Depends on community solidarity and general willingness to pay.
- **Bespoke tariff model**
 - Could rely on an 'intelligent' consumer being able to accept the right tariff for them.
 - You could say when you get to 60 you can access a special tariff (bus pass tariff.)
 - The big challenge for the new company is to recruit customers. Having a range of tariffs may not be a bad thing.
- **A model focused entirely on local authority tenants**
 - Worth considering that there are lots of older people (who comprise a significant proportion of the fuel poor) living in the social rented sector.
 - Should include social housing as opposed to just local authority tenants.
 - Only 25% of those in fuel poverty are social housing tenants.
 - Too narrow.
 - Regarding the model focused on Local Authority tenants, we don't think that this is something that should be offered just to local authority tenants, but they could form a key part of a wider user base (?). There is a big issue of price instability so a model that provides longer term fixed tariff would be good across the board.
 - Vast proportion of older people are in owner occupied accommodation.

- **Subsidized tariff model**

Anything involving cross-subsidy depends on community solidarity – and a lower cost for some relies heavily on people (paying the higher end) signing up for it.

Subsidised tariff model has most impact on fuel poverty.

3. White Label Supply Criteria to consider when choosing a White Label supplier:

- Customer service (call centre as well as online) Good customer service needs to be balanced against cost sometimes
- Billing – legacy billings, flexible billing systems, modern, regular and accurate billing
- Reputation
- Energy source (percentage renewable)
- Sustainable business model
- Ethical
- Scottish
- Big six or not big six (are the big six too big, is a medium size supplier best? Must remember Government will face media interest re procurement – choices re big six and Scottish are potentially politically sensitive)
- Energy Company Obligation (ECO), Warm Homes Discount offering
- Treatment of those in debt (need to consider who is recovering debt, reputational risk for Scottish Government)
- Focus on addressing some Scottish specific issues. switching, Low Meter Coverage, Low sign up to Priority Services Register etc.

For White Label supply	Against White Label supply
Takes the risk away from Scottish government (SM)	What is the point in adding in more confusion? (KB)
	What happens if the White Label supplier goes bust? Supplier of last resort kicks in and then your White Label kicks in? (KB)

Attendee list:

Jamie Macleod, Scottish Government	Jamie Stewart – Citizens Advice Scotland
Neil Ritchie, Scottish Government	Ragne Low – University of Strathclyde
Alan Clark, Scottish Government	Elizabeth Leighton – Leighton Consulting/Existing Homes Alliance
Ann McKenzie, Scottish Government	Matthew Crighton – Friends of the Earth Scotland
Michael Berrington, Grant Thornton	Jim Eadie, Age Scotland
Neil Peckett, Grant Thornton	Peter Spiers, Scottish Renewables
Adam Boorman, Cornwall Insight	Jon Clarke, Community Energy Scotland

James Higgins, Ecuity	Dr Keith Baker, Glasgow Caledonian University
Alex Jones, Ecuity	Simon Markall, Energy UK
Norman Kerr, OBE – Energy Action Scotland	Sarah Boyack, Scottish Federation of Housing Associations
Dr Johanna Carrie – Transition Edinburgh	Iain Wright, Common Weal

10 Appendix C – Soft market testing memorandum

Below is the memo sent to market, as outlined in the Commercial Case section 5.16.

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Scottish Government is in the process of developing an Outline Business Case supporting the development of a Public Energy Company.

Project overview

The First Minister announced the intention to establish a publicly owned energy company (Public Energy Company) on 10 October 2017. The aim of the Public Energy Company is to provide competitively priced energy to help alleviate fuel poverty in the Scottish market.

Opportunity

The Public Energy Company will be looking to procure a white label agreement with an existing energy supplier to provide energy (gas and electricity) and service functions to its customers. Scottish Government is committed to have a Public Energy Company offering by the end of the current parliament (March 2021). The initial objective is to help reduce fuel poverty by offering competitively priced energy and encouraging disengaged customers to switch suppliers in order to secure a better deal for their energy supply. The customer base focus will be on domestic customers in Scotland, although it is recognised that customers from further afield will be permitted to switch to the Public Energy Company.

In 2018, a Strategic Outline Case for the Project was published and Scottish Government are currently in the process of developing and publishing an Outline Business Case. They are therefore looking to discuss this opportunity with the market to assess the desire to be involved in the Project.

Key benefits of the opportunity

- Opportunity to work with Scottish Government
- Potential to increase brand awareness through the partnership
- Additional revenue stream
- Income without the need for provision of marketing
- Ability to negotiate the terms of the white label agreement including pricing structure

Key risks and issues

1. **Insufficient take up of offering** – there is a risk that there is not sufficient uptake by customers. Scottish Government will need to ensure the offering is attractive to customers and the marketing strategy is well tailored and appropriate to encourage customers to switch from their current provider.
2. **Reputational risk**– there is a risk of adverse publicity or association resulting from poor offering or service provided by the Public Energy Company. Due to the relationship with Scottish Government this Project involves there is an increase in the level of public scrutiny it is likely to receive.

White Label Arrangement

Scottish Government is looking for a potential partner to enter into a white label agreement with.

Scottish Government foresee that the chosen third-party supplier would provide energy and customer services to the Public Energy Company's customers, with Scottish Government (and potentially Local Authorities) being responsible for marketing to attract customers. Scottish Government would anticipate receive income from the energy supplier in the form of either sign-up fees and/or on-going annual customer retention fees.

Key questions

Scottish Government would like to discuss the appetite of the market for taking a role in this Project. Key questions they would like to answer include:

- Would you consider being involved in the Project?
- Who are your target market in terms of customer focus?
- How would you describe your interest and focus on helping to alleviate fuel poverty?
- What is your strategic agenda in relation to renewables and innovative energy solutions?
- What are your core values as a company?

11 Appendix D – Financial Modelling Assumptions

Operating costs (Opex)

The costs of operating the Public Energy Company are limited due to the selection of a White Label company as the preferred option. In a company set up in this manner, many of the costs of operation are borne by the third-party energy supplier, for example, customer service and infrastructure costs. The table below shows the annual operating costs of the Public Energy company, the assumptions column provides an explanation of the formation of the cost. All cost assumptions have RPIx applied to them in the Financial Model. In order to present a 'rounded' view of the costs of establishing the Public Energy Company, we have included the set-up cost assumptions. For both the Acquisition Model and the Retention Model the same underlying operating costs are assumed.

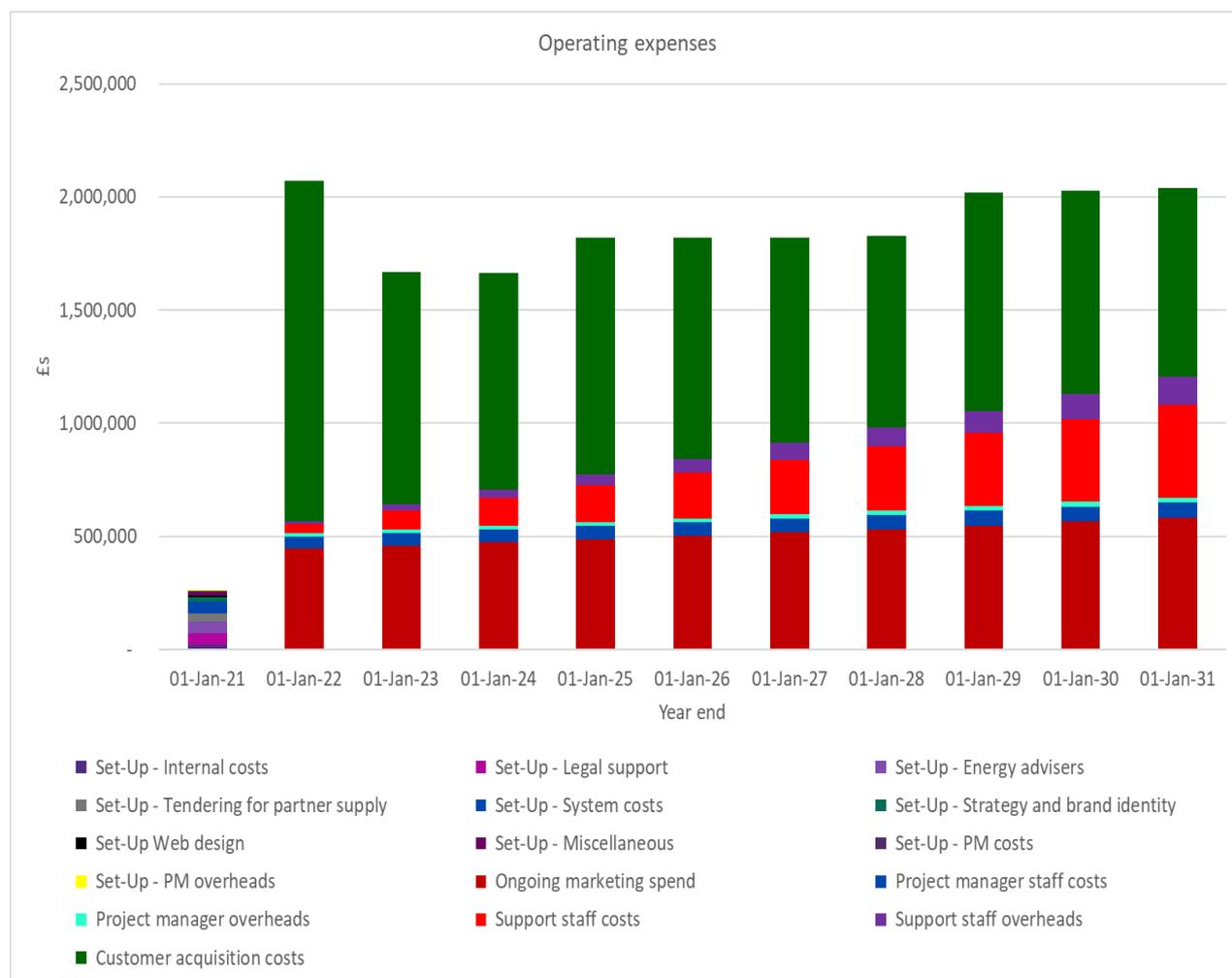
Table 63 - Operating costs

Cost type	Value Core £	Value Optimistic £	Value Pessimistic £
Set-up costs			
Internal costs	£20,000	£15,000	£35,000
Legal support	£50,000	£40,000	£75,000
Energy advisers	£50,000	£40,000	£75,000
Tendering for partner supply	£35,000	£25,000	£50,000
System costs	£50,000	£25,000	£100,000
Sub-total – Set-up costs	£205,000	£145,000	£335,000
Marketing costs (incurred during set-up phase)			
Strategy and brand identity	£20,000	15,000	30,000
Web design	£8,000	5,000	15,000
Set-up / Miscellaneous	£15,000	10,000	20,000

Sub-total – marketing (set-up) costs	£43,000	35,000	65,000
Ongoing operating costs			
Ongoing marketing spend	£420,000 per annum	£360,000 per annum	£520,000 per annum
Project Manager / Co-ordinator costs	£65,000 per annum	£65,000 per annum	£65,000 per annum
Support staff costs	£26,000 per annum (1 required per 20,000 customers)	£26,000 per annum (1 required per 22,000 customers)	£26,000 per annum (1 required per 15,000 customers)
Customer acquisition cost – single meter	£20.00 per customer	£12.50 per customer	£22.50 per customer
Customer acquisition cost – dual fuel	£30.00 per customer	£22.50 per customer	£37.50 per customer

The figure below demonstrates the operating expenses incurred on an annual basis, incorporating the impact of indexation.

Figure 13 - Operating expenditure



Revenues

Revenues for the Public Energy Company are comprised of income from fees earned from the White Label Supplier to the Public Energy Company. In the retention model, these are provided as a one-off value on an initial sign-up basis. In the acquisition model, the Public Energy Company is assumed to receive ongoing retention fees on a monthly basis. The two figures below demonstrate the annual revenues under each set of core assumptions that have been assumed for the Project.

Figure 14 - Revenues - Retention Model

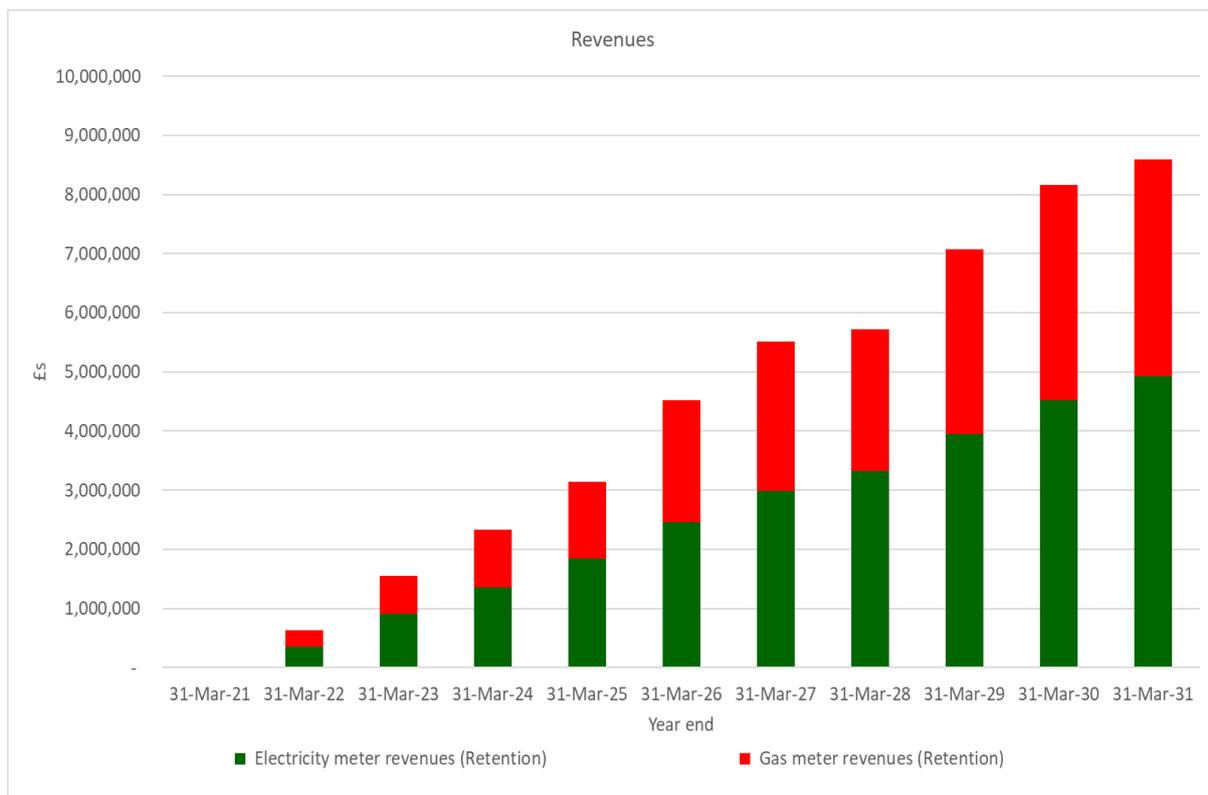
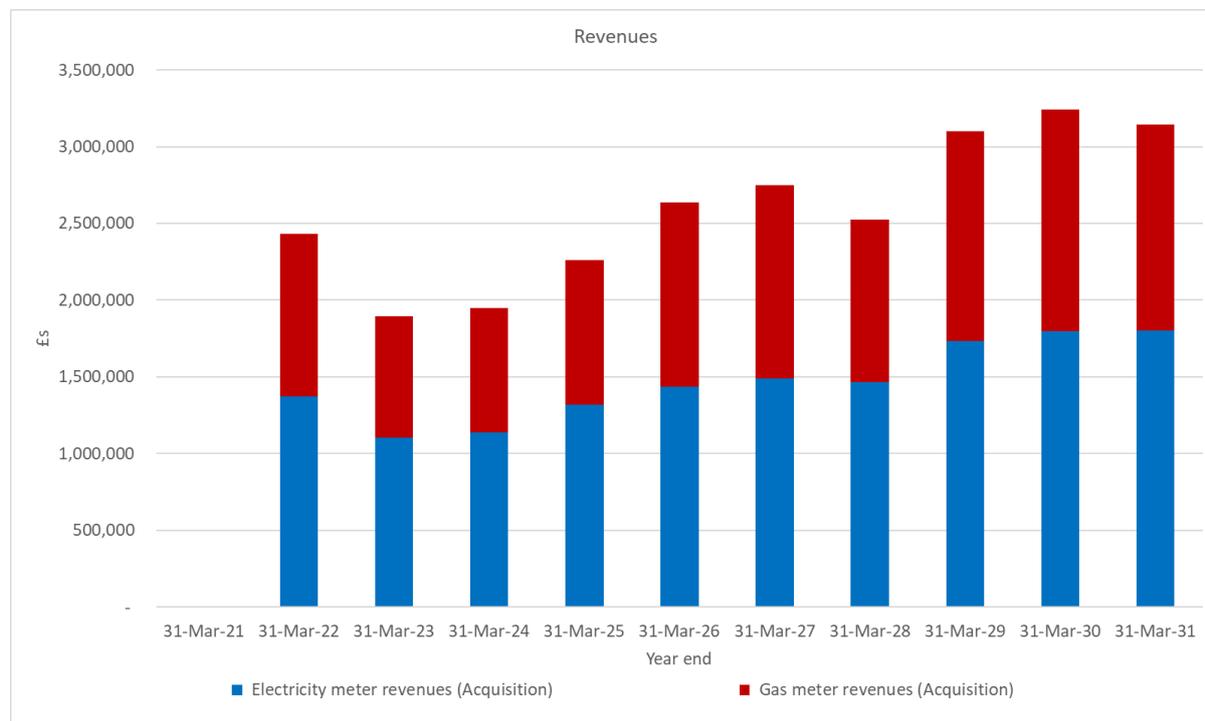


Figure 15 - Revenues - Acquisition Model



Retention model - ongoing retention fees

Under the Retention model, we have assumed that the Public Energy Company will come to a contractual arrangement with the White Label energy supplier, whereby the supplier pays the Public Energy Company an agreed amount for each month that a customer remains with the Public Energy Company. This will have the benefit to the Public Energy Company of providing a (relatively) stable monthly income stream that can be used to subsidise activities. From the Public Energy Companies perspective, it also encourages Scottish Government to seek an agreement with an energy supplier that will prioritise quality of service delivery, as a satisfied customer is less likely to switch energy supplier.

The table below demonstrates the level of retention fees forecast under the core, optimistic and pessimistic scenarios.

Table 64 - Retention model - revenue assumptions

Revenue type	Value Core	Value Optimistic	Value Pessimistic
Amount received from energy supplier – first meter connected (assumed to be electricity)	£1.00 per month	£1.10 per month	£0.80 per month
Amount received from energy supplier – two meters connected (i.e. both electricity and gas connection assumed)	£2.00 per month	£2.20 per month	£1.60 per month

Percentage of customers assumed to be dual fuel (i.e. signing up with two meters)	69.45%	69.45%	69.45%
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Acquisition model - initial sign-up fees

As an alternative to the Retention model, the contractual arrangement that the Public Energy Company comes to with the White Label energy supplier may be on an 'acquisition' basis. Under this model, the energy supplier pays the Public Energy Company a one-off payment for each customer that the Public Energy Company are able to sign up. This approach has the benefit of providing significant up-front cash inflows to the Public Energy Company (although it is recognised that in reality there may be a 'claw back' if a newly signed up customer does not stay with on their tariff for an agreed period).

The table below demonstrates the acquisition fees forecast under the core, optimistic and pessimistic scenarios.

Table 65 - Acquisition model - revenue assumptions

Revenue type	Value Core	Value Optimistic	Value Pessimistic
Amount received from energy supplier – first meter connected (assumed to be electricity)	£25.00 one-off	£30.00 one-off	£20.00 one-off
Amount received from energy supplier – two meters connected (i.e. both electricity and gas connection assumed)	£50.00 one-off	£30.00 one-off	£20.00 one-off
Percentage of customers assumed to be dual fuel (i.e. signing up with two meters)	69.45%	69.45%	69.45%

Funding

The funding structure for the Public Energy Company reflects the current thinking. Through the Commercialisation and Procurement phases this will need to be developed further in light of the final agreed procurement route and structure of the SPV.

The core scenarios assume that a Public Energy Company in the form of a company limited by shares will be established, into which investors can make a pinpoint equity investment in proportion to their ownership. The quantum of this amount reflects that it is not the principal source of funding for the Public Energy Company and is at sufficient levels to establish the Public Energy Company. This is therefore £1,000 for each investor into the Public Energy Company. Cash surpluses for funding initiatives aimed at reducing fuel poverty, will be paid out of the Public Energy Company in accordance with the ownership structure.

As noted in the Commercial Case, further legal advice should be sought to ensure an appropriate commercial vehicle is selected. In particular, the results presented in this Financial Case include the impact of corporation tax on the trading profits of the Public Energy Company. Should the commercial arrangement be set up such that the Public Energy Company is established as a charitable entity with a trading subsidiary, there is a potential that these trading profits could be paid via gift aid to the charity for use in charitable activities, thus obviating the need to pay corporation tax. The need for flexibility in future would however need to be considered if this approach was to be pursued, and how this may impact on future intentions of the Public Energy Company

The development and initial operational requirements of the Public Energy Company are structured to be met through an issue of debt to the company. This is set at a level to provide sufficient working capital such that e.g. an overdraft is not required in addition to this amount.

For the avoidance of doubt, the core, optimistic, and pessimistic scenarios all have the initial provision of debt flexed to ensure no additional overdraft is required.

The debt is repaid to the investors on a 10-year annuity basis, with interest charged at 5.09%, assessed to be a State Aid compliant interest rate. For the avoidance of doubt, there is no security associated with these payments – investors will be exposed to the risk that the Public Energy Company does not generate sufficient cash flows to cover these payments.

Amount of capital investment required

The initial funding requirements (including the impact of RPIx) are shown in the table below.

Table 66 - Investor requirements – Retention Model

Year to	Mar 2021 £000s	Mar 2022 £000s	Mar 2022 £000s	Mar 2023 £000s	Mar 2024 £000s	Mar 2025 £000s	Mar 2026 £000s	Mar 2027 £000s	Mar 2028 £000s	Mar 2029 £000s	Mar 2030 £000s
Scottish Government											
Loan drawdown	(2,914)	-	-	-	-	-	-	-	-	-	-
Interest received	143	131	118	105	91	77	61	45	28	10	-
Capital repayments	229	241	254	267	281	296	311	327	344	362	-
Net investment	(2,541)	372	372	372	372	372	372	372	372	372	-
Cumulative investment	(2,541)	(2,169)	(1,796)	(1,424)	(1,052)	(679)	(307)	65	438	810	810
Dividends received											
	-	-	-	-	-	1,838	2,987	3,168	4,129	5,033	5,385

Table 67 - Investor requirements – Acquisition Model

Year to	Mar 2021	Mar 2022	Mar 2022	Mar 2023	Mar 2024	Mar 2025	Mar 2026	Mar 2027	Mar 2028	Mar 2029	Mar 2030
	£000s										
Scottish Government											
Loan drawdown	(297)	-	-	-	-	-	-	-	-	-	-
Interest received	15	13	12	11	9	8	6	5	3	1	-
Capital repayments	23	25	26	27	29	30	32	33	35	37	-
Net investment	(259)	38	38	38	38	38	38	38	38	38	-
Cumulative investment	(250)	(221)	(183)	(145)	(107)	(69)	(31)	7	45	83	83
Dividends received											
	-	61	177	225	353	665	757	567	885	998	908

The tables above present the annual investment position for the investors under both the Retention Model and the Acquisition Model. This takes into account not only the initial loan drawdown, but also receipts from the Public Energy Company. It shows that:

- Under the Retention Model the loan required is £2,914k, receipts exceeding this amount by 31 March 2027. In addition, the model releases dividends of £22,540k which could be utilised in programs to address fuel poverty
- Under the Acquisition Model the loan required is £297k, receipts exceeding this amount by 31 March 2027. In addition, the model releases dividends of £5,597k which could be utilised in programs to address fuel poverty

12 Appendix E – Approach to Economic Model

In Section 4.7.14 and below we have detailed our reasoning behind the initial inputs to the model.

Customer Revenue

Initial customers

Initial customers are those who would be with the Public Energy Company when it is created. This has been set at zero as the Public Energy Company will be a new creation without an existing customer base.

However, it may be possible for the Public Energy Company to negotiate the acquisition of a base of customers prior to go live who will be switched to it at go-live to provide an initial pool of customers over which to defray their costs. For example, this could include social housing or housing associate properties being switched as a group. Such an activity would incur a supplemental cost, which is not considered here.

Annual customer growth

Annual customer growth is the number of customers the Public Energy Company acquires within a year. For the purpose of this analysis, we have assumed a flat acquisition profile with an equal number of customers acquired every month, although in practice we would anticipate intra-year peaks and troughs.

We have assumed that the target for the Public Energy Company would be to secure a 5% market share of domestic Scottish consumer energy contracts within three years of go-live. This target has been based on the targets that have been set by other Publicly Owned Energy Companies³². Based upon Scottish census data³³ there are 2,451,869 households in Scotland, giving a target customer base of 122,600 customers by the end of Year Three. This equates to 41,000 customers per year.

However, we have assumed that the Public Energy Company will benefit from higher switching rates in Year One as the public recognition of the supplier and media coverage of the launch increases consumer awareness and switching rates.

For the later years, we have assumed a slightly increased switching rate (45,000 customers/year) due to a combination of population growth, the continued trend of increasing switching rates through growing customer engagement fostered by the wider aspirations of the Public Energy Company, and the 'proven' nature of the Public Energy Company following several years of successful operation.

³² [Norwich City Council White Label](#)

³³ [National Records of Scotland – Scottish Census Data](#)

Percentage dual fuel

This variable sets the percentage of customers who switch both electricity and gas meters to the Public Energy Company. This value is based upon government data on the percentage of customers who are connected to the gas grid in Scotland (80%³⁴) and Cornwall Insight data on – of those customers who are connected to the gas grid – the percentage of Scottish customers who are supplied under a dual fuel arrangement (86.8%³⁵). This provides the figure of 69.45% expected dual fuel customers.

Revenue

Based upon Cornwall Insight's experience in the market, White Label Suppliers are typically remunerated in one of two different payment structures:

- **Acquisition payments.** These are payments made by the partner licensed supplier to the White Label when the customer is acquired. These are similar in structure to the payments seen by other potential routes to market for licensed suppliers, such as price comparison websites. These are typically set between £15-30/meter (£30-£60 per dual fuel customer) depending on a range of factors, including:
 - The tariff signed up for, with longer-term tariff deals and/or higher margin tariffs providing a greater payment;
 - Agreed terms and conditions between the White Label partner and the White Label Supplier (i.e. the Public Energy Company in this case);
 - The licensed supplier's growth ambitions; and
 - The strength of the brand the White Label Supplier can bring to the partnership, with a stronger brand typically able to receive higher payments.
 - For the Core case, we have set these at **£25/meter** to reflect not only the strength of public sector brand, but also the Public Energy Company's objective to be a social enterprise with lower tariffs and social offerings
- **Ongoing retention payments.** Under this system, the White Label Supplier receives an ongoing (typically monthly) payment for each customer meter they retain. This payment is lower than the upfront acquisition payment but provides an ongoing reward for retaining the customer and provides higher lifetime value if the customer can be retained for a number of years. The typical values seen for these ongoing payments is £0.80-£1.10/meter/month (equivalent to £19.20-£26.40/year for a dual fuel customer).
 - As with the acquisition payments these are typically based on the strength of the White Label Supplier's brand, the licensed supplier's growth ambitions, and potentially the tariff being offered.
 - For the Core case we have set the value at **£1/meter/month**

³⁴ [Sub-national Estimates of Properties not Connected to the Gas Network](#)

³⁵ Source: Cornwall Insight analysis

As with other aspects of White Label supply, the potential payment structure and value will be based upon the individual negotiation and contract agreed between the Public Energy Company and the partner supplier.

Therefore, while the Economic Model values represent Cornwall Insight's understanding of the **current** market situation, they may not reflect the final agreement secured for the Public Energy Company at the conclusion of any tender exercise and subsequent negotiations for a White Label partner.

Set-up costs

These represent the costs incurred to establish the Public Energy Company.

Internal costs

In addition to the costs incurred with external specialists, Scottish Government will also need to dedicate internal resource to the establishment of the supplier. This value reflects the commitment of Scottish Government resource to the Project.

The Core Case value of £50,000 has been based on upon a dedicated Project manager for the establishment and ongoing oversight of the Project.

Legal support

White Label supply is at its heart a contractual relationship between the White Label Supplier and the partner Fully Licensed supplier (i.e. **the White Label partner**). Therefore, legal support to ensure the robustness of the contract between the Public Energy Company and its White Label partner will be essential to provide reassurance to Scottish Government regarding the supply arrangement.

The Core Case value has been based upon Cornwall Insight's discussions with parties in the public sector and Local Authority arena who have been through the process.

Energy advisers

In addition to legal support, expert energy adviser services will be needed to provide a commercial review of the White Label partnership agreement, the tariff offerings proposed, and the broader market situation the Public Energy Company is entering.

The Core Case value has been based upon Cornwall Insights experience with parties in the public sector and Local Authority arena who have been through the process.

Tendering for partner supplier

There will be a requirement to undertake a full tender exercise for a White Label partner in compliance with prevailing rules on public sector procurement.

On the assumption that Scottish Government undertakes the tender based upon the **Restricted procedure** (or equivalent), we assume that this will take a minimum of 60 days to complete from the point at which the tender notice is published through to the completion of the ten-day standstill period.

This period does **not** include time which may be required for the Public Sector investors to undertake negotiations as to their requirements or specific criteria for the Public Energy Company, which we anticipate will be undertaken via COSLA.

The stated figure in the model therefore represents the assumed cost of hiring specialist advisory support for the procurement process, reflecting Cornwall Insight's expectation of a comparable public sector body. In the event that this tender process was managed in-house by Scottish Government, a corresponding cost would be incurred through staff time and resources.

System costs

White Label supply does not require the White Label Supplier to procure or utilise specialist industry facing systems. Instead the White Label Supplier utilises the Fully Licensed supplier's industry and CRM systems. Therefore, there is no 'direct' system cost associated with White Label supply.

However, due to the desire for the Public Energy Company to be a partnership with a number of different Local Authorities and the need to internally track progress for the Public Energy Company we have assumed a low system fee for Scottish Government to expand a system it currently owns or acquire a simple off the shelf CRM system to track the Public Energy Company's progress.

In the event of no such pre-existing system being in place, this would of course represent a supplemental cost for inclusion in the model.

Staffing

Due to its partnership with the Fully Licensed supplier the staffing requirements for a White Label Supplier are relatively low.

Typically, White Label Suppliers operating in the market employ a Project manager to oversee and coordinate the White Label Supplier's activities. In addition to this role there are a number of support staff, who are normally linked to the number of customers the White Label Supplier has gained.

Based on our understanding of the Publicly Owned Energy Companies operating in the market to date we believe that one support staff per 20,000 customers is a representative figure (i.e. 1 x FTE per annum or part thereof per 20,000 customers).

Marketing

The marketing values represent the spend expected to establish the Public Energy Company's brand within the market and the ongoing costs associated with marketing activities.

Strategy and brand identity

The high-level strategy and objectives for the Public Energy Company have already been defined by Scottish Government.

However, these will need to be translated into a workable engagement plan for the Public Energy Company as to how it will engage with customers and potential Local Authority (and wider public sector participants) alike. This is in addition to the general costs associated with creating the look and identity of the brand, e.g. fonts, document templates, graphic design etc.

While there will be an element of limitation associated with templates due to the use of the White Label partner's systems, we assume that the Public Sector investors will

either wish to secure the development of these services on an in-house basis or through an external agency. In both cases, there will be a need to coordinate the activities of the Local Authority participants to ensure consistency of message.

The Core Case value of £20,000 has been based on upon a marketing and brand manager/agency for six months to establish the Project.

Web design

Under a White Label arrangement, there is relatively little required for the establishment of a website, as the partner supplier provides the customer enrolment portal and (typically) the provision of the website for use by the White Label partner. Therefore, this spend has been set at a low level to reflect personalisation and branding of the website rather than its complete design and build.

Set up/miscellaneous costs

This category represents other spend needed to establish the identity and strategy of the Public Energy Company and to provide flexibility and reserve for the establishment of the Public Energy Company.

Ongoing marketing spend

This figure represents the ongoing spend by the Public Energy Company for marketing activities. We have assumed that for the Core scenario the Public Energy Company will undertake relatively little national marketing activity, relying instead more on local campaigns aligned with the partner Local Authorities, the brand of the Public Energy Company, and the free marketing activity received as Scottish Government supplier from media coverage.

Therefore, there is assumed to be no direct centrally incurred expenditure, although we anticipate that there will be a cost incurred by the Local Authorities – for which no explicit allocation has been made.

Acquisition

Cost per new customer

This cost represents the additional cost per customer the Public Energy Company faces to attract a customer beyond the marketing budget and the support staff time. This reflects further activities such as face to face sales, local workshops, pop-up/physical stores.

Given the social objective of the Public Energy Company we have assumed that it will be predominantly targeting the harder-to-engage consumers and so will face a higher cost per new customer than we would typically see for a supplier as it will be more focused on face to face sales and engagement events.

Additionally, in order to reflect the combination of fixed and marginal costs for customer acquisition we have assumed that the cost to acquire the first customer meter will be higher to reflect the need to recover the sunk fixed costs, while the cost of acquiring the second meter in a dual fuel arrangement will be lower as it will predominantly be the marginal cost of acquisition.

Annual customer churn

This represents the percentage of customers who switch away from the Public Energy Company on an annual basis. As with the acquisition rate we have applied

this as a flat monthly figure. The average annualised customer churn for a domestic-only energy supply is approximately 20% (as at the Q2 2019 figures, it was 21.9%). Given the assumed target customer base of the Public Energy Company and the anticipated level of engagement with the energy market, a lower figure was applied to the model.

Acquisition fee

We are aware that a number of White Label contracts have in place protections to prevent against incomplete, frequent or erroneous switching.

These typically block the payment of the acquisition fee if the switch does not occur within 60 days, or the customer switches away from the White Label within the same timescale.

This is accommodated by the ability to apply such protections (by typing “Yes” or “No”) in the applicable cell.

It is assumed that this takes effect from Year 2 onwards.



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