This report is not for publication under Part 1 of Schedule 12(A Local Government Act 1972, para 3 (Information relating to the financial or business affairs of any Particular person (including the authority holding that information)

Exempt Appendix J2: Exempt Financial Commentary – Bristol Energy Limited (BE)

1. Overview

1.1. Following receipt of the initial response of the bidders in the City Leap procurement and the operational update provided in February 2020, which indicated a deteriorating financial position (primarily due to market conditions); it has become evident that Bristol Energy (BE) will need to be restructured or transformed to align with the market changes and make it much more likely that the desired outcomes of the City Leap project will be achieved.

1.2. The financial position as outlined in the BE business plan has materially changed and following a high level review and assessment of the latest financial position, Ernst and Young(EY) has been commissioned to provide professional advice on the options available to the Company and Council. An interim report prepared by EY (See Exempt Appendix J1) has highlighted that at this point in time, without acceleration or additional funding the company would currently be unable to pay its debts as they fall due.

1.3. Work is on-going to fully assess the options available to BE and the Council in:

- mitigating the extent of any additional further funding requirements beyond the peak working capital cap;
- systematically examining potential threats, opportunities and make improvements to the performance of the company, which may include restructuring; and
- consider likely future developments in markets, which are at the margins of current thinking and could enhance the value of the company as part of the City Leap partnership proposal.

1.4. The commentary in this report does not focus on the above work as this is in its infancy and will be subject to a full report when more detailed information is available. It's important that the Council fully assesses the financial position and risks to which it may be exposed and ensures that any draw down of funds are, justifiable, affordable and undertaken in a planned manner. Therefore the primary focus of this report is the cash position and the potential impact on the Council's finances as the sole shareholder.

2. Business Plan Update

2.1. The latest version of BE business plan 2020/21 to 2024/25 was approved by Cabinet in 21 January 2020. To date (as at 24th February 2020), the Council has invested a total of £35.0m (sunk costs) in BE via Bristol Holding: £8.8m in ordinary share capital and £26.2m in 7% preference share capital. The plan submitted to Cabinet indicated that planned activity could be delivered within the previously set total peak cash funding envelope of £37.7m.

2.2. Based on current assessment the latest indicative funding requirement is outlined in the recently received operating cash-flow forecast (see tables 1 and 2 below). Whilst these forecasts have not been formally approved by the Council, they indicate that without remedial steps, the previously authorised funding cap of £37.7m would be materially exceeded.

Table 1 – Operating Cash Flows Latest Forecast

Bristol Energy - Latest Forecast Cash Position February 2020 - £m

Month	Operating Cash Flows	Funding	Net Cash Flows	Cum Funding *	+/- Cap
					39.70
Jan-20	(1.12)	1.20	0.08	34.90	4.80
Feb-20	(2.02)	1.30	(0.72)	36.20	3.50
Mar-20	(0.97)	1.50	0.53	37.70	2.00
Apr-20	(1.97)	2.00	0.03	39.70	-
May-20	0.32	-	0.32	39.70	-
Jun-20	1.06	-	1.06	39.70	-
Jul-20	1.33	-	1.33	39.70	-
Aug-20	(7.23)	3.00	(4.23)	42.70	(3.00)
Sep-20	1.23	-	1.23	42.70	(3.00)
Oct-20	1.04	-	1.04	42.70	(3.00)
Nov-20	(0.08)	-	(0.08)	42.70	(3.00)
Dec-20	(1.16)	-	(1.16)	42.70	(3.00)
Jan-21	(1.28)	2.50	1.22	45.20	(5.50)
Feb-21	(1.57)	-	(1.57)	45.20	(5.50)
Mar-21	(0.69)	-	(0.69)	45.20	(5.50)
Total	**(13.11)**	**11.50**	**(1.61)**		
Cl COH			**0.1**		

** Including Innovation Fund £2m*

Table 2 – Funding Position based on Latest Forecast

Bristol Energy - Latest Funding Position / Request - February 2020 -

Month	Share Issues	PTD
		33.70
Jan-20	-	33.70
Feb-20	1.30	35.00
Mar-20	1.50	36.50
Apr-20	1.20	37.70
May-20	-	37.70
Jun-20	-	37.70
Jul-20	-	37.70
Aug-20	3.00	40.70
Sep-20	-	40.70
Oct-20	-	40.70
Nov-20	-	40.70
Dec-20	-	40.70
Jan-21	2.50	43.20
Feb-21	-	43.20
Mar-21	-	43.20
Total	**9.50**	**43.20**
Agreed Cap		**37.70**
+/-		**(5.50)**

2.3. The residual £2.7m (from the £37.7m envelope) is earmarked within the Capital Investment reserve for allocation in 2020/21. The forecast indicates that an acceleration of this fund is likely to be required in March 2020 (c. £1.5m) and April 2020 (c. £1.2m) for BE to meet obligations as they fall due within that period. The Council intends to accelerate the availability of the residual funds but given the risks that further funds may be required (which would need to be considered in conjunction with the option appraisal) and wider transformation that may ensue, **this draw down should be subject to a determination by the Section 151 Officer that further investment remains in the public interest.**

2.4. Ofgem issues the electricity generators with Renewables Obligation Certificates (ROCs) relating to the amount of eligible renewable electricity they generate. They can be traded, and ultimately are used by suppliers to prove that they have met their renewable generation obligations. The Renewables Obligation schemes provide support to renewable electricity generators and the UKs journey to a net zero emission economy by 2050. BE's legacy liabilities related to its Renewable Obligations and the level of unscheduled payments to Ofgem in relation to mutualisation across the industry from residual costs when companies become insolvent over the financial year(which generally have a time lag) is estimated to c.£8.4m. The current cash-flow (not approved) indicates a shortfall in August 2020 of £3.0m when this payment is due. If any supplier undermines the scheme by failing to comply with the payment deadline, Ofgem will take strong enforcement action that could lead to their licence being revoked. **The position in relation to sufficiency of BE's provision for this payment is being closely monitored.**

2.5. BE is being positioned by City Leap as 'the engine inside City Leap' to deliver energy services propositions, energy infrastructure and heat retail. The City leap cabinet report approved £4m (earmarked capital investment reserve) for procurement activities, project team, professional advisors and the innovation funds to prepare and demonstrate the opportunities which will arise from City Leap. This figure is proposed to be increased by a further £1.5m in the budget recommended to Council giving a total of £5.5m for the project. **The extension of the scope of the EY contract (valued at approximately £0.150m plus expenses) is to be funded from the approved City Leap programme budget.**

2.6. The City Leap Programme has entered into a contract for £2m with BE for innovation services in readiness for City Leap. The City Leap Team have been working in collaboration with BE on a number of development projects to support critical delivery outcomes, providing information and the evidence base required to feed into the Invitation to Submit Outline Solutions, and maximising the value of the City Leap offer. **From this contract the first £1.2m was paid in January 2020 following release of the draft ISOS and further payment of £0.8m is anticipated in March 2020 under this contract.**

2.7. **The total additional funding to April (only) of £3.5m would remain within the agreed financial envelope and would be funded as planned from within the earmarked Capital investment reserve.**

3. Collaterals.

3.1. The Council has provided BE counterparties with a number of Parent Company Guarantees (PCG's) to support the credit lines required for standard business operation. These PCGs are in place to indemnify the supplier against any potential losses should BE, be unable to perform its obligations under the contracts with those parties. As agreed by Cabinet the maximum value of PCG's is limited (capped) at £17.6m. The actual level of PCG's currently issued (February 2020) is £16.45m (which is within the overall agreed cap of £17.6m). This figure is the actual agreement with counterparties not actual liabilities and not reflective of potential future exposure. BE's peak credit exposure for Gas and Electricity is during the winter months Dec / Feb, when maximum consumption occurs and is the key switching period. **Moving out of winter will reduces the peak monthly consumption to which the Council could potentially be exposed.**

3.2. An assessment is regularly undertaken in relation to the sufficiency of the Council's earmarked and general reserves and the Council's ability to mitigate this risk should the need arise and a regulator led disposal ensue. Regular reports are provided by BE to enable the Council to actively monitor the position during the course of the year and take the necessary action to reduce activity or increase the risks provision as required.

4. Accounting Treatment

4.1. Included in the financial accounts year ended **31st March 2019** is the fair value of the Council's investment in its subsidiary companies. In BE's case, the calculation was based on an Enterprise value (EV) per customer meter point, as if the company were to be sold on the open market as a going concern. Having sought advice at the time, £75 per customer had been reported (recognising that the transition to an Energy Service will see a significant increase in this value) as a minimum valuation, reflecting the current changes in the projected profitability and examples of recent market transactions. This produced a valuation of £12.4m (based on c.165.6k customer meter points) and led to £12.1m impairment on the Council's investment. This was reflected in both the Council's accounts and Bristol Holding's accounts for 2018/19.

4.2. For the accounts year ending **31st March 2020,** If market sales prices remain in line with prior year (average £75), given the reduction in customer meter points to c.102k (38% reduction) December 2019 (to be updated March 2020) and increase investment to March 2020 (£36.5m) this will result in a further impairment in the 2019/20 accounts in the region of £16.8m. whilst this is an indicative position which will need to be updated to reflect actual year end position, it is clear that **there is likely to be a significant movement in the fair value in the accounts and it should be noted that impairment is an accounting treatment and the actual value of any investment will never be known until a disposal actually occurs.**

4.3. **Financial Instruments -** The Councils PCG's have previously been treated as contingent liabilities with a simple disclosure note in the Council's accounts. However following the introduction of IFRS9 an assessment needs to be made as to whether the contract between the Council and the holder of the PCG (Counterparty) represents a financial instrument. **The new assessment approach indicates that the PCG's create a liability for the Council contingent on the failure of BE to fulfil its contractual obligations.** As such the treatment of these financial instruments under IFRS9 is to value at Fair Value through the income and expenditure account. The indicative fair value calculation for the PCG's exposure at 31 March 2019 utilising a weighted probability is estimated to c. £0.854m. This methodology is still subject to the approval of the Councils External Auditors and if endorsed will be applied to PCG exposure levels as at 31 March 2020 (prior year adjustment in the 2018/19 accounts) and ongoing adjustment in the Risks reserve.

5. Other Risk

5.1. The actual level of customer debt, amount set aside for bad debts and the cash receipts position in terms of % billing recoverable is unclear. In addition the assumptions in relation to credit balances that could transfer with decrease in customer numbers is not transparently built into cash flow forecast – presenting an even greater risk to the deliverability of the latest BE cash-flow.

6. Risk Reserve

6.1. Given the changes required in the accounting treatment for PCG's and other potential risks and liabilities summarised in this report, there is a reasonable level of fund in the earmarked risk reserve of £7.3m, which it is anticipated could be used to mitigate these issues should they arise, it is recognised that a further report will be prepared for Cabinet outlining the next steps following conclusion of the EY assignment.

6.2. In the intervening period should the need arise to make an emergency payment to BE, delegated authority is sought for the Deputy Mayor for Finance, Governance, Performance (in his role as Shareholder Representative), in consultation with s151 Officer to consider this request in line with the scheme of delegations and drawing down the relevant funds from this risk reserve.

6.3. The proposal in this report does not result in any changes to the annual 2020 budget, the Councils general reserve or resilience reserve as recommended to full Council for approval.

It is recommended that the BE position and BE Board action plans are closely monitored for alignment with the City Leap market soundings, the Board and Council can act in an agile way in responding to market conditions and give appropriate consideration to the options appraisal and risks.

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