

## **CABINET – 25 NOVEMBER 2014**

### **ELECTRICITY AND GAS PROCUREMENT 2016-2020**

#### **Report by Deputy Director - Commercial**

#### **Introduction**

1. The Council spends just over £10.5m a year on electricity and gas supplies. It needs to establish supply contracts to procure this energy in compliance with our legal obligations and to secure value for money.
2. Challenges outlined in the 14/15 Corporate Plan include finding a further £90 million of annual savings. Energy procurement helps the council meet these financial challenges and is part of having efficient 'back office services'.
3. Since 2009, the Council has procured electricity and gas through LASER, a Professional Buying Organisation<sup>1</sup> (PBO) established by Kent County Council (KCC). LASER provides energy procurement and contract management on behalf of its public sector members. LASER currently procures energy for over 160 public organisations including 115 local authorities, representing over £350 million of energy contracts every year.
4. The current agreement with LASER runs until the end of September 2016. Because LASER purchases a proportion of the energy up to two years in advance, it has just completed the OJEU procurement to appoint the energy providers for the period October 2016 to September 2020, with purchases in advance starting in September 2014.
5. The Council will need to decide by the end of December 2014 whether it wishes to continue to procure its future energy requirements for the period 2016-2020 through LASER. The commitment is required by this date so that LASER can include the Council's estimated demand in its aggregate advance procurement volumes.

#### **Background**

6. A reliable, good value and risk aware (in terms of management and mitigation of commercial risk and security of supply) energy supply is essential for all of the Council's activities.
7. Since the deregulation of the commercial energy markets, the Council has needed to establish an effective and legally compliant energy procurement strategy.
8. The current agreement with Laser comes to an end in 2016, giving the Council an opportunity to review its approach to energy procurement.

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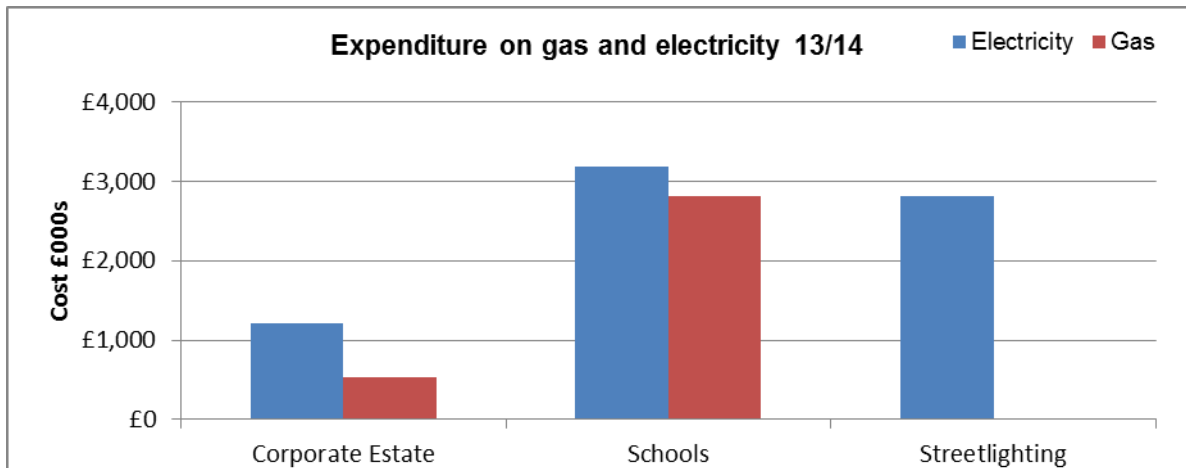
<sup>1</sup> An organisation within the public sector whose primary purpose is to buy goods and services, or put in place commercial arrangements, on behalf of or for use by other organisations.

9. The options are:
  1. Do nothing
  2. Procure our own energy by direct tender
  3. Procure via a PBO
10. These options are compared in more detail in Annex A

**Current energy consumption and challenges**

11. The table below shows Oxfordshire County Council’s expenditure on electricity and gas in 13/14, and the percentage change in costs compared to a 10/11 baseline. The graph shows the 13/14 expenditure broken down by electricity and gas for the corporate and schools estate, and street-lighting. Further detail on energy is contained in the 13/14 Energy Review, available on request.



13/14 costs and percentage change 2010/11 to 2013/14		
	Cost £ million	Change from 2010/11 baseline
Corporate buildings	£1.8	1%
Schools	£6.1	-2%
Street lighting	£2.8	17%
<b>Total</b>	<b>£10.70</b>	







12. The price of energy has increased year on year since 2010/11, although costs have been offset by decreased energy use on the corporate estate due to property disposal.
13. The price of energy is determined not only by the commodity costs of gas and electricity but also regulated fees and charges. The fees and charges are likely to increase steeply over the next few years<sup>2</sup>. The Council will not solely be able to rely on procurement to control energy costs and energy is likely to be an increasing cost-pressure.

14. Risk-managed energy procurement can however, help to get the best price for the commodity by spreading market price risks and avoiding buying during periods of peak market pricing. Gas and electricity market prices are highly volatile. Market price movements of more than 10% in a week are not unprecedented. The Pan Government Energy Project recommended that “all public sector organisations adopt aggregated, flexible and risk-managed energy procurement” such as the framework contract provided by LASER.

**Preferred option – Value for money**

15. The preferred option is to continue using the energy framework contract established by LASER:
- This acts like a ‘buying club’, whereby Oxfordshire joins neighbouring authorities in the south east and beyond. Negotiation of prices with energy suppliers takes place based on energy supplies worth £350million rather than with just the Council’s £10million.
  - The approach is compliant with the EU procurement regulations.
  - LASER provides the aggregated, flexible, and risk-managed approach recommended, and expertise in energy-buying for local authorities.
  - LASER is independently benchmarked, whereas independent information is often not available for other public buying organisations. The latest independent Value for Money Assessment by the London Energy Partnership<sup>2</sup> confirms Laser’s past purchasing performance to be effective.
16. The London Energy Partnership<sup>2</sup> report evaluated average market price with achieved purchase price, and rated LASER’s performance as “very good”  for three of it’s purchasing options, and “effective”  for the fourth.

LEP Achieved Price Benchmark Summary						
LASER						
Benchmarked Supply Periods	Risk Management Option	RAG Assessment	Average Market Price	Achieved Purchase Price	Performance Against Benchmark	Performance Against Benchmark
ELECTRICITY – Purchase In Advance (PIA) and Purchase Within Period (PWP)						
October 2010 – September 2013	PIA		£49.04/MWh	£48.55/MWh	£-0.49/MWh	-1.0%
October 2010 – September 2013	PWP		£49.04/MWh	£48.61/MWh	£-0.43/MWh	-0.9%
GAS - Purchase In Advance and Purchase Within Period						
October 2010 – September 2013	PIA		59.00p/th	59.91p/th	+0.91p/th	+1.5%
October 2010 – September 2013	PWP		59.00p/th	58.67p/th	-0.33p/th	-0.6%

17. The report<sup>2</sup> makes the following recommendation:

*“Participating Authorities may continue using aggregated, flexible, risk managed energy contracts as provided by LASER, a division of Kent County Council Commercial Services i.e. to engage a strategic risk managed approach that delivers overall best performance, as a means of achieving value for money as part of their wider energy strategy.”*

18. With the caveat that past performance is no guide to future performance, over the four years from October 2009, LASER estimate their achieved prices for wholesale energy equate to avoided costs to the Council of £3,157k per annum had we been paying maximum market prices, £222k per annum had we been paying average market prices. Together with other costs that make up energy prices such as supplier management fees, LASER estimate total avoided costs to the Council of £803k per annum<sup>3</sup>.
19. Based on a snapshot of current consumption, the supplier management fees for the Council will reduce under the new framework by about £48k (39%) per annum, or £195k over the duration of the 4-year framework, compared to the previous framework.
20. At a meeting of the Central Buying Consortium Energy Buying Group in May there was a consensus across all local authorities currently using LASER to remain with LASER for the 2016-2020 period. Local Authorities form the vast majority of the Buying Group and includes Hampshire County Council. This consensus view supports the argument that there is no compelling case to change at this point in time.

### **Procurement requirements**

21. Legally, KCC is the contracting authority for the energy supply contracts and will continue to be for the new ones awarded this year. It is a “Central Purchasing Body”, as defined in the Public Contracts Regulations, which means that Oxfordshire Council can legitimately and compliantly access the energy framework contract without needing to run its own tender process.

### **In-contract purchasing options**

22. LASER is now offering an increased number of purchasing options which balance cost against risk. In the past there were two options: Purchase in Advance (PIA) and Purchase within Period (PWP). There will be four extra options in the new contract.
23. Historically, the Council has used the PIA option which means that it knows the cost of its energy at the start of each six month purchasing period. This will still be the only option for schools. The Council needs to consider whether to continue or change this approach for all or some of its corporate buildings.

<sup>2</sup> London Energy Project. 2013. Energy Contracts. Value for Money Assessment 2010 – 2013. Achieved Prices Benchmark & Risk Assessment Report.

<sup>3</sup> LASER. 2014. Flexible Energy Frameworks 2016 – 2020 Information Pack. Oxfordshire County Council

24. Laser does not require a decision on the purchasing option until March 2016. They will track the comparative performance of the different options in the interim period so that the Council can make a more informed decision nearer the time.
25. Since this is a technical issue, the Cabinet is asked to delegate this decision to the Deputy Director - Commercial.

### **Financial and Staff Implications**

26. The decision on energy procurement will have a financial impact in three broad budget areas: Corporate buildings (paid from the Corporate Landlord function); Schools (paid from delegated budgets); Streetlighting (paid from Highways budgets). The total spend is set out in paragraph 11.
27. Proceeding with LASER is unlikely to reduce energy bills paid from these budgets without further action to reduce energy consumption. This option will however help the Council to avoid paying maximum market costs for energy (illustrated in the table below). LASER has in the past achieved wholesale prices below the market average).

<b>Oxfordshire County Council's annualised wholesale energy costs 2009-2013*</b>		
<b>Maximum Market Prices</b>	<b>Average Market Prices</b>	<b>% Differential</b>
£8,551.1k	£5,615.8k	52%

\*what the Council's average annual wholesale energy costs would have been, based on maximum/average market prices. Wholesale costs typically form 50-70% of delivered energy costs.

28. If the Council decides to proceed with an energy framework contract with LASER there are no staff implications. The other options set out in Annex 1 may require specialist staff time and expertise to be bought-in.

### **Equalities Implications**

29. There are no equalities implications.

### **RECOMMENDATION**

30. **The Cabinet is RECOMMENDED to:**
- (a) approve the proposal to using the energy framework contracts established by LASER for the period 2016-20.**
  - (b) delegate to the Deputy Director – Commercial the authority to decide on the preferred in-contract purchasing option.**

MARK KEMP  
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October 2014

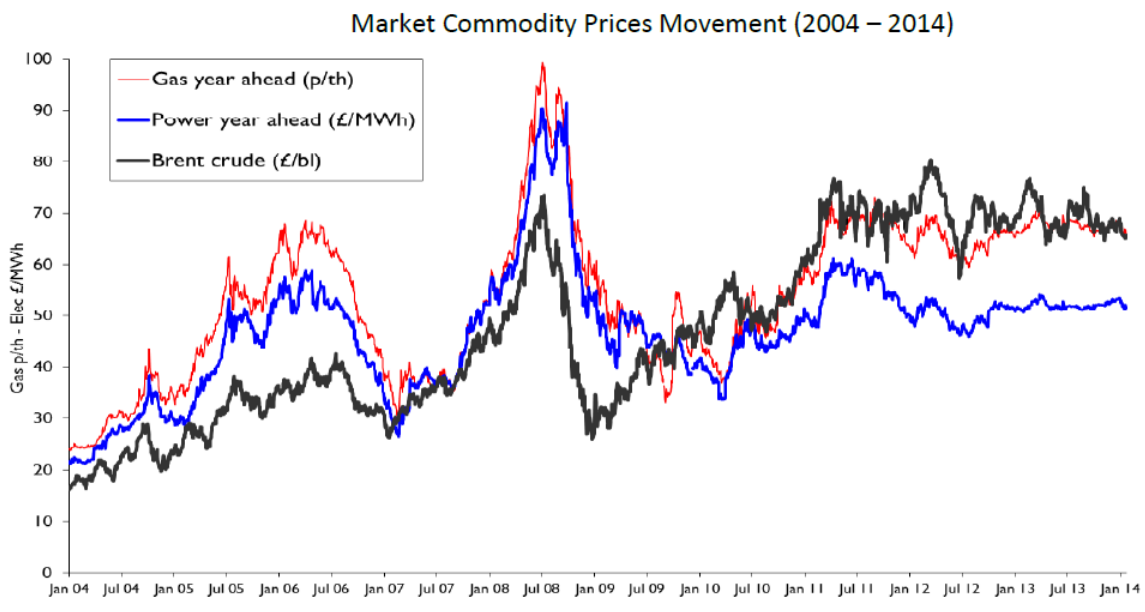
## ANNEX A – COMPARISON OF PROCUREMENT OPTIONS

1. The options are:

- 1 Do nothing
- 2 Procure our own energy by direct tender
- 3 Procure via a PBO

### Do nothing

2. Once out of its current agreement with LASER the Council is likely to find itself paying higher 'off-contract' prices for the energy for its buildings and street-lighting after October 2016, whilst also being exposed to the risk of energy price fluctuations. The Council would also be in default of the EU procurement regulations. Whilst always an option therefore it is neither commercially sound nor is it legally compliant, and it fails to provide an acceptable level of risk mitigation against energy price volatility.



### Historic Energy Market Price Volatility

Source: LASER. 2014. Flexible Energy Frameworks 2016 – 2020 Information Pack.  
Oxfordshire County Council

### Direct tender

3. This option would involve the Council undertaking a standalone OJEU tender for the provision of its own energy independent of a PBO or any other intermediary, and contracting directly with the selected energy provider(s). Whilst on the one hand this gives the Council a degree of control over the procurement process and its outcome, the downside includes:

- higher energy prices through the loss of aggregated volume
  - greater risk of exposure to energy price fluctuations
  - loss of access to skilled energy traders and energy category expertise
  - contract management falls to the Council, with staff resourcing implications
4. This approach is also not recommended by the London Energy Partnership<sup>2</sup> especially a fixed term fixed price contract, or 'spot purchasing' - a high risk strategy that is unlikely to be effective in controlling commodity costs.
  5. Analysis for the period – 01 October 2011 – 30 September 2013 indicates that the risk of spot purchased gas and electricity contracts was significant. For 45% of trading days in this period spot purchased (FTFP) contracts were priced higher than the Average Market Price and for 24% of trading days were in the top third of commodity prices. For gas, 55% of trading days spot purchased (FTFP) contracts were priced higher than the Average Market price and for 41% of trading days were in the top third of commodity prices.

### **Procure via a PBO**

6. There are a number of PBOs in existence. PBOs offer a fully managed, flexible and risk managed approach to energy procurement and employ staff who possess the relevant category expertise and energy trading skills. The principal PBOs offering access to energy contracts are:
  - Yorkshire Purchasing Organisation (YPO)
  - West Mercia Energy (WME)
  - Eastern Shires Purchasing Organisation (ESPO)
  - Crown Commercial Services (CCS – formerly the Government Procurement Service)
  - London and South East Region (LASER)
7. Most of these are groupings of adjacent public authorities which have pooled their buying power to secure better value for money. Frequently, an authority joins the nearest appropriate group. The Council is a member of LASER which is owned and operated by Kent Commercial Services, a trading arm of Kent County Council (KCC). KCC is itself a member of the Central Buying Consortium (CBC), a PBO in its own right largely comprising authorities from across the south east region and of which the Council is a full member.
8. All PBOs are not-for-profit organisations, which recover their costs through a management fee.
9. Given the above, the recommendation is that option 3 is selected on the grounds that it most closely aligns to successful delivery of a reliable, risk aware (in terms of management and mitigation of commercial risk and security of supply) and good value energy supply essential for all of the Council's activities. Should this recommendation be agreed, the next required decision is whether to continue to use LASER or to explore joining another PBO. The case for this is set out in sections 12-16 of the Cabinet paper.

### LASER vs other PBOs

10. Table 1 is a summary comparison of LASER with the other PBOs. Detailed benchmarking information not available publicly for other PBOs, so it is difficult to compare them financially. Changing contracts between suppliers is likely to involve a cost. There is no compelling case to change PBO

**Table 1 – Summary Comparison**

	<b>LASER</b>	<b>Others</b>
Prices	The actual purchase price is not known at the start of the contract. It depends on the behaviour of the market and the purchasing strategy of the buyer.	
Service	Once a contract has been set up, our contract is direct with the energy companies. Therefore, for a procurement-only contract, service is not a deciding criterion.	
Switch-over cost	There will be no switch-over cost	Because the start dates relating to the supply contracts of other PBOs are not the same as LASER, it is likely that there will be a cost to stopping and starting a contract.
Evidence of best value	Through our membership of the London Energy Partnership <sup>4</sup> , we have a number of reports demonstrating that LASER is good value for money (see main report).	Little information available publicly.
Management fees	Laser recovers its costs through an annual charge per meter, which varies with the fuel and type of meter. For the last full year, the total was 0.57% of the total bill at £58k.	Not known but any savings would probably be outweighed by the cost of transfer.

<sup>4</sup> A Partnership consisting of a consortium of businesses, government and public bodies that acts as an independent body in promoting sustainable energy solutions.



