

To: Delegated Decisions of the Board Member, Cleaner Greener Oxford

Date: 29th June 2011

No:

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Report of: Heads of Environmental Development and Business Improvement

Title of Report: ENERGY PROCUREMENT 2012 - 2016

Summary and Recommendations

Purpose of report: To update the Board Member with the savings made from the energy supply contracts that the Council has had in place with LASER for the last 2 years and to request approval to authorise LASER to tender our energy requirements as part of a larger contract package for a number of public bodies for the period 2012 to 2016.

Key decision? Yes

Executive lead member: Councillor John Tanner

Policy Framework: An efficient and effective Council

Recommendation(s):

- 1) Grant project approval to use LASER, the public sector specialist energy buying consortium for a further 4 years (2012-2016) to tender the Council's energy requirements.
- 2) Approve the energy purchasing route set out in section 6 of this report, and to use the LASER service to enter into new energy contracts based on Flexible Purchasing using the Purchase In Advance option. This will enable the Council to manage the ongoing price/risk in a volatile energy market. This is in line with the recommendations of the professional energy buying consortia.
- 3) The greenest available energy will be sourced whenever it is economically viable to do so.
- 4) Delegate authority to the Director for City Services to enter into the new replacement energy contracts identified by the process as set out in recommendations 1, 2 and 3.

1. Summary

- 1.1 This report sets out the options for purchasing and managing our energy supply arrangements for up to the next four years, explains why energy procurement requires specialist support to leverage the best pricing and supply arrangements and recommends that the Council appoints LASER to manage our energy procurement requirements to do this on our behalf.
- 1.2 LASER stands for Local Authority South East Region and is a buying consortia.
- 1.3 The Council entered into a contract with LASER to purchase the majority of its electricity and gas in 2009. This enabled the Council to take advantage of the group buying power of this local authority run consortium to source cost-competitive energy for its estate. CEB approved this as the most effective procurement strategy for our energy purchasing in April 2009. The Council has been managing price risk for large energy consuming sites through the Flexible Purchasing contract. In addition smaller consuming sites (e.g. quarterly invoiced) have been purchased via a group fixed-term fixed price contract arranged via LASER to take advantage of bulk discounts possible via this route.
- 1.4 The current flexible contracts were secured by LASER in 2008, following a tendering exercise in compliance with EU procedures to cover the supply period October 2008 to September 2012. The selected suppliers were British Gas (for gas supplies) and Npower (for electricity supplies). Oxford City Council moved its large energy contracts to the flexible arrangement with LASER in the October 2009 following CEB approval in April 2009.
- 1.5 The next flexible procurement cycle is now being prepared by LASER for the subsequent four year period (October 2012 to September 2016) for which we are requested to indicate our commitment to continue this option for another four years. LASER has requested responses by the end of June 2011. LASER has recently undertaken a further tender exercise to appoint suppliers for the next period via an OJEU tender process. The successful suppliers for this next period are:

Total Gas and Power (Gas); and
Npower (electricity)

2. Background

- 2.1 The Council currently spends just under £2 million a year on gas and electricity across all of its buildings. The expenditure is split as follows:
- Gas - £0.51million
 - Electricity - £1.34million

The current budget for both categories in 2011/12 is £1.8million. The current split between Gas and Electricity is £0.5m and £1.3m.

2.2 The contracts for electricity and gas are broken down by typical annual consumption and meter type at the site – with larger accounts currently on flexible contracts to manage price risk (as these make up the bulk of energy spend at the Council). The smaller electricity accounts (quarterly billed sites) have been on a group fixed-term, fixed price contract, as the recommended approach to take with smaller consuming sites at the time of the previous contract.. They are listed as follows with renewal dates (and typical annual consumption figures in kWh):

- Gas (greater than 73,268kWh/2500therms) – covering 31 sites - Flexible Purchasing Contract- renewal date - Oct 2012 (ca 14,900,000kWh)
- Electricity half hourly (HH) metered sites – covering 9 sites - Flexible Purchasing Contract- renewal date Oct 2012 (ca 5,600,000 kWh)
- Electricity monthly billed non-half hourly (MNHH) metered sites – covering 5 sites – Flexible Purchasing Contract-renewal date Oct 2012 (ca 800,000kWh)
- Electricity – quarterly billed non-half hourly metered sites – covering ca 400 sites - Fixed-term, Fixed price contract renewal date Oct 2012 (ca 1,800,000kWh)

2.3 The Council is currently paying (via LASER) a weighted average of ca 8.5 pence per kWh for large electricity sites (HH and MNHH) and ca 2.7 pence per kWh for gas at the sites under the current flexible purchase contract (this price is valid until 30 Sept 2011 after which a new rate will be calculated for the final year of the current flexible purchase contract running from October 2011 to September 2012). The quarterly billed electricity sites are billed an average of ca 9.6pkWh for the fixed-term fixed-price contract (expiring 30 September 2012).

3.0 Savings

3.1 The performance of LASER can be seen at Appendix 1. This Cabinet Office report assessed LASER's energy purchasing performance for the period April 2009 to February 2011. The report demonstrates an exceptional and consistent performance achieved by LASER over the period. Under the flexible purchasing arrangement that Oxford City Council opted for (Purchase in Advance) LASER outperformed the benchmark price by 7% and 6% respectively for electricity and gas supplies. (See 3.2)

- 3.2 In terms of the Purchase in Advance option performance, it is only possible to estimate any savings against LASER's performance against benchmark (Appendix 1). For example, for electricity, taking the performance that we are buying 7% better than the benchmark, if the Council had bought at the higher rate it would have spent £38,080 per annum more (ie 7% increase in spend based on annual consumption/unit price of 6,400,000kWh @ 8.5p kWh) and for gas at 6% better than the benchmark, if the Council had bought at the higher rate it would have spent £24,138 per year (ie 6% increase in spend based on annual consumption/unit price of 14,900,000 kWh @ 2.7p kWh). The purchase in advance contract covers the bulk of electricity and gas consumption across the core Estate.
- 3.3 In terms of savings from the Fixed term fixed price contract arranged via LASER for the smaller consuming (quarterly billed electricity sites) , the last reported savings for the quarterly bills was estimated at ca £48,000 per year based on the rate that the Council paid in the previous contract. It is difficult to calculate the actual reduction associated with these accounts as it covers over 400 individual metered accounts across the Estate across a range of cost-centres, however the total electricity spend for 09/10 was ca £118k under budget – so it is likely that some of this reduced energy spend was due to the reduced p/kWh rate during 09/10 alongside improved energy awareness across the council. LASER also stated that “With regards to accepting the price, we plan to negotiate Oxford as part of a bulk negotiation. Therefore, Oxford would benefit from other authorities energy requirements to reduce the price. We believe that this saves in the region of 5%”

4.0 Energy Purchasing

- 4.1 Since gas and electricity markets opened to competition in the 1990's, the energy market has become a highly specialised field of procurement. The complexity of the procurement options can create a risk if not managed by someone with the appropriate level of skills and expertise. It is also time consuming due to the potential number of suppliers and types of contract available.
- 4.2 In the previous non-volatile market it was possible to purchase energy without detailed specialist expertise. However, since 2006 the market pricing has changed and specialist buyers monitor the market on a daily basis to ascertain the best opportunities to purchase energy, including advance purchasing. Specialist support is now required to ensure value for money and appropriate risk management levels are applied.
- 4.3 Several buying organisations, both private and public sector, can secure such contracts on our behalf. Public sector organisations are favoured because they focus solely on public sector needs rather than trying to match the potentially competing objectives and requirements

of private and public sector organisations. In addition, these groups have a long experience of acting on behalf of the public sector and are therefore well versed in their requirements and processes. Lastly, they will certainly comply with EU procurement rules.

5. What is Flexible Purchasing?

5.1 Flexible contracts differ from historical arrangements in that the volume of use is covered through many purchases of components (“known as clips”) of the total requirement over a period of time, rather than all in one purchase.

5.2 There are two options within their Flexible Purchase arrangements – Purchase in Advance (PIA), and Purchase within Period (PWP)

- **Purchase in Advance** – all purchases are concluded prior to the supply period (1st October to 30th September) so that the price for the supply period is known by the start of the supply period.

Purchase Within Period – some or all purchases are completed within the supply period. Generally, this is a more risky strategy but can result in better prices overall. In such an arrangement, a target price is established for invoicing purposes and this is reconciled against actual prices either after each billing period or at the end of the supply period (usually one year).

5.3 In each case, various control mechanisms are put in place, e.g. high and low price trigger points which are set to influence purchasing decisions; however any individual decision to purchase is not automatic but requires the agreement of two or more professional buyers employed by the consortia.

6.0 Why use Flexible Procurement as an effective Energy Purchasing Route?

6.1 Flexible procurement offers the Council a risk managed way of purchasing energy in a complex and volatile market. It is recommended for all public bodies by the Pan Government Energy Review Project (Cabinet Office)

6.2 The benefits of flexible procurement include:

- Energy markets are one of the most volatile commodity markets. The flexible approach provides access to wholesale markets, aggregation of public sector demand and enables a strategic market approach with long term hedging.
- Wholesale energy prices are influenced by many different aspects. For example: exchange rates, geopolitical issues and weather trends. Purchasing

energy over longer periods of time using a hedging strategy will somewhat mitigate the risk.

- 6.3 Based on LASER's performance over the past few years against the market rate it has performed consistently well in obtaining better than benchmark costs for energy (See Appendix).
- 6.4 Based on the advice provided by LASER and the Council's preference for knowing the energy price before the contract start date, it is recommended that the Council opt for Flexible Purchasing – Purchase In Advance (PIA) for our electricity and gas sites - (half-hourly electricity, monthly non-half hourly, and large gas points – see 2.2 for details of sites/types of account).
- 6.5 In the past LASER recommended that the pragmatic solution for the large number of small consuming quarterly NHH sites was to negotiate a fixed term fixed price contract with the existing supplier using market analysis to determine the timing and duration of contract. Given changes in regulations however this is no longer an option and going forward, LASER now recommends that the NHH Quarterly sites are either tendered within a fixed price fixed term framework or included within the flexible purchasing framework as with the larger consuming sites .
- 6.6 Further discussion with LASER's procurement specialists advise that the former option (tendering within a fixed-priced fixed-term framework) would prove administratively burdensome with the supply industry possibly also only being willing to offer a one year or two year at best fixed price contract arrangement. The volumes of supply we would be tendering for these smaller sites in today's market are not seen as an attractive offering for the supply industry given that many are smaller consuming sites and would present additional administrative burdens to the supplier themselves for relatively low return (ie administrative process of setting up many individual low value accounts,). For that reason the uptake of interest via a fixed price fixed term tendering process is expected to be low for this option in today's market and we may not be able to secure the best price or best supply option. At the end of the contract period (most likely 2 years maximum) the same procurement process would need to be undertaken each time with the corresponding burdens of potential change of supplier again – and the issues that can arise here (invoicing problems/errors, inconsistency in billing process and internal disruptions/increased administration) . The costs for carrying out this procurement option via LASER would be £22 per site per year (ca total of £9152/year across ca 416 sites paid for within the billing process – eg estimated at £5.50 per invoice per quarter)
- 6.7 Bringing the Quarterly billed sites within the flexible procurement framework would mean we would not only benefit now from managing price risk for these sites – as we currently do with the larger supplies - but also reduce the administrative burden of a regular change of supplier that the former option would entail. As with the larger supplies, we would remain with the selected framework supplier from LASER's EU tender

process (Npower) for the flexible contract for a minimum of four years (this is also guaranteed to be Climate Change Levy exempt green suppliers – see Section 9.3).

6.8 It is therefore recommended to bring the Quarterly billed sites within the flexible purchasing contract. LASER's view is that they are unlikely to be able to deliver added value to the NHH quarterly sites on a fully managed basis (as with the larger contracts) under the flexible purchase option for these sites. It is recommended therefore to opt for the Procurement only service offering which will cost £27 per site per year (ca total of £11232/year across ca 416 sites paid for within the billing process – eg estimated at £6.75 per invoice per quarter). Therefore, for an additional £1.25 per invoice per quarter for the smaller electricity sites we will get the benefit of price risk managed energy purchase through flexible purchasing (as with the larger sites), supplier continuity for a minimum of four years and reduced administrative burden of continual tendering and changing of suppliers through a fixed term fixed price tendering process.

7.0 Options

7.1 **Do nothing** - this will result in Oxford City Council trading out of contract which will mean that the organisation is not compliant with EU Procurement regulations and will undoubtedly result in the Council spending significantly more on its energy procurement.

7.2 **Tender the Contracts Independently** – This would mean going through a procurement exercise and independently trying to get the best deal in a complex market. Officers within the Council do not have the specialist knowledge or buying power to achieve a satisfactory result. In addition, buying fixed (spot) priced annual, or longer, supplies on a single day is a high risk strategy with a 1:220 chance (based on 220 working days in a year) of getting the best price (London Energy Project 2011). The Council also does not have the required purchasing volumes to be able to purchase energy in a flexible arrangement via the wholesale market so would not be able to purchase energy itself in this way.

7.3 **Use the Office of Government Commerce or another buying consortium** - The OGC provides specialist energy procurement on behalf of central government and local authorities. They are able to offer us the procurement service but do not offer the same level of ongoing support in relation to contract management as is offered by LASER. There are also other consortiums that exist regionally across the UK, for example the Eastern Shires Purchasing Organisation (ESPO). ESPO can offer a similar type of arrangement to LASER and has similar buying powers, however as highlighted in option 4, ESPO does not offer the invoice validation service, which is unique to LASER.

7.4 **Continue to use LASER for the majority of the Council's energy purchasing** - LASER specialises in energy purchasing for local authorities and offers a complete procurement service. It is run by Kent County Council. It manages tenders electronically and has a reputation for achieving excellent pricing. LASER has a good reputation with the supply market. Considerable savings are achieved, not just at the actual point of procurement but through the management of the contract and ongoing supplier relationship. These services are offered as part of their ongoing service management and include:

- Support with billing issues, including bill validation on the larger sites
- Assistance with new sites and changes
- Collection of the Climate Change Levy

(Please refer to the LASER performance data at Appendix 1)

8.0 Risk Management

8.1 There is a small risk that the recommended purchasing option is not the better option when calculated over the year if the wholesale utility market performs very differently from the prediction given by the consortia over the next few months. This is a low to medium risk as these agencies have the most skill and expertise in the public sector and are highly skilled in this type of purchasing.

8.2 At any point during the tender period the market could change so it is difficult to predict the outcome of the likely savings with any certainty until after the tender process is complete.

8.3 The agencies are constantly checking the market and our energy purchasing will be a very small part of the larger volumes purchased. The consortia use the usage levels to bulk purchase in advance whenever there is any drop in the price even though we may not use the energy until a later date.

8.4 It is proposed that we enter into 'Flexible Purchasing - Purchase In Advance' which enables LASER to purchase our energy requirements at the prices being offered leading up to the new contract start date at times whilst the pricing is offered at more competitive rates.

9.0 Climate Change/Environmental Impact

9.1 The energy buying proposal will have no adverse impact on our carbon dioxide emissions.

9.2 The greenest available energy will be sourced whenever it is economically viable to do so. It should be noted that under all energy/carbon reporting

legislation any lower carbon content of electricity from renewables or other low carbon generation technologies is not acknowledged (i.e. we cannot claim any additional carbon savings from greener energy supplies).

9.3 Under the current flex framework contract (2008-2012) with Npower the core supply is a green supply in the form of Climate Change Levy (CCL) exempt good quality Combined Heat and Power generation (QCHP). The proposed flex framework presents an improved renewable energy offering for the October 2012 - September 2016 period with approx. 50% of current LASER portfolio volume coming from CCL exempt carbon free renewable energy with the balance being CCL exempt QCHP (as in the current framework agreement). There is an aspiration from LASER to maintain the ratio against a potential increase in portfolio volume and to increase the carbon free renewable element when possible.

10.0 Equalities Impact

10.1 There are no equalities implications.

11.0 Financial Implications

11.1 The current budget allocated for energy procurement is predicated on what the Council spent last financial year. There is no inflationary element built in. The budget in 11/12 for gas and electricity across the council (including HRA sites) is £0.5m for gas and £1.3m for electricity

11.2 After discussions with LASER the Council is hopeful that it will be purchasing both gas and electricity at a similar rate to what they are currently doing. If the rate increases it may be possible to draw on the Energy Fund to create a buffer against price increases. The creation of an energy fund was agreed in the previous energy purchasing CEB report (April 2009). It should be noted that although agreed this fund has yet to be actioned and as such there is currently no balance available to act as a buffer

12.0 Legal Implications

12.1 LASER, which was set up specifically to manage energy procurement on behalf of local authorities, uses the EU procurement regime for all their procurement activity. It therefore complies with both the Council's own procurement requirements and external regulation.

Appendices to report – Appendix 1 – Performance of LASER

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List of background papers:

Version number: 4