

**SURREY COUNTY COUNCIL****CABINET****DATE: 28 APRIL 2015****REPORT OF: MS DENISE LE GAL, CABINET MEMBER FOR BUSINESS SERVICES****LEAD OFFICER: MRS JULIE FISHER, STRATEGIC DIRECTOR FOR BUSINESS SERVICES****SUBJECT: PROCUREMENT OF ELECTRICITY AND GAS SUPPLIES FOR 2016-2020****SUMMARY OF ISSUE:**

The report seeks approval from Cabinet to commit to flexible energy purchasing contracts through the LASER (Local Authorities in South East Region) framework for the provision of electricity and gas supplies on a rolling two year basis, to commence on 1 October 2016. The report provides details of the procurement process, including the results of the options appraisal, and demonstrates why the recommended contract award delivers best value for money.

**RECOMMENDATIONS:**

It is recommended:

- (1) That SCC commits to the energy purchasing contracts through the LASER Flexible Framework for the provision of electricity and gas supplies to commence on 1 October 2016 and run until September 2020 on a rolling 2 year basis for the energy requirements of the council and in respect of participating schools following the receipt of appropriate warranties.
- (2) That SCC adopts, as part of the LASER framework, a mixed basket of Purchase in Advance (PIA), Purchase within Period (PWP), Fully Managed Service, Procurement Only Service and other purchase options as may be deemed suitable to manage energy price risk as appropriate to the needs of the end users and the nature of the energy supply.
- (3) That authority be delegated to the Head of Procurement and Commissioning and Chief Property Officer, in consultation with the Cabinet Member for Business Services to take necessary procurement decisions and award new contracts from 1 October 2016 to September 2020 on a rolling two year basis through the framework agreement for the supply of electricity and gas under a flexible procurement.
- (4) That SCC makes use of the added value services available from framework suppliers to LASER customers, such as data collection from automated meters, where it is cost effective to do so.

**REASON FOR RECOMMENDATIONS:**

A compliant Official Journal of the European Union (OJEU) tender process has

recently been completed by LASER, resulting in 2 new contracts being awarded for Electricity and Gas supplies, permitting access by other public sector organisations from 1 October 2016 to 30 September 2020. The suppliers on the framework are Npower for electricity and Total Gas & Power Ltd for gas. Using the LASER framework for 2016-2020 will provide continuity for sites and best value for money for the council following a thorough options appraisal. A rolling two year commitment is preferred to a four year commitment as it affords the council more flexibility.

The requirement to forward purchase energy ahead of the supply period is a key part of any risk managed energy strategy. Having the option to secure electricity and gas volume for the period October 2016 to September 2020, well in advance of delivery, is vital in protecting LASER customers against potential wholesale market price changes. The LASER new framework recommends a minimum two-year window to complete future flexible energy purchases. Without this window, LASER is unable to forward buy energy requirements on behalf of its customers in response to market price changes. To enable LASER to commence purchasing energy requirements from 1 October 2016 onwards, and to take advantage of potential favourable buying opportunities, it is recommended that the council commits to the LASER Flexible Framework for the provision of electricity and gas supplies. Where a customer provides commitment to join the framework, energy purchases will commence for that customer's portfolio once their commitment is received.

#### **DETAILS:**

##### **Background**

1. Within the Medium Term Financial Plan for 2015/16, the council has budgeted for expenditure of £3.1m on gas and electricity for corporate buildings and £3.6m for street lighting. The current best estimate for schools is £6.7m which brings the total to £13.4m.
2. Energy usage and related costs can be heavily influenced throughout the year, particularly dependant on the severity of a cold winter. However it should be noted that over the last 4 years savings totalling £2.7m have been achieved.
3. Since 2009, the council has procured electricity and gas through LASER, a Central Purchasing Body<sup>1</sup> (CPB) 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. As LASER purchases a proportion of the energy up to two years in advance, it has now undertaken a further tender exercise to appoint suppliers for the subsequent 4 year period October 2016 – September 2020.
5. In order for SCC to join the LASER Framework, and continue to purchase energy, SCC needs to give a commitment to LASER by May 2015. LASER must have this commitment because it has to establish energy annual usage

<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.

and profiles in advance of the new framework. LASER intends to purchase blocks of energy (or clips) well in advance of the contract start in October 2016.

6. The contracts for gas and electricity will cover the energy requirements of the council including buildings, street lighting and Schools that confirm their participation in the framework.

### **Procurement Strategy and options considered**

7. Several options were considered when completing the Strategic Sourcing Plan (SSP) prior to commencing the procurement activity. These were:
  - Option 1 – Do nothing
  - Option 2 – Procure our own energy by direct tender
  - Option 3 – Procure through a Private Sector based provider
  - Option 4 – Procure from generators
  - Option 5 - Generate own energy
  - Option 6 – Procure via Central Purchasing Bodies (CPB)
8. These options are compared in more detail in Annex 1

### **Options Appraisal**

9. Option 6 was 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. The appraisal also determined which CPB was the most appropriate. The case for joining LASER is set out in the section of this report entitled Preferred route. However; a range of selection criteria can be applied as shown in the table below to demonstrate the benefit of the option 6.

Option	CRITERIA						
	Economy of Scale	Eliminates need for SCC Resources	Guarantee of Supply	Environmental Credentials	Geographical coverage/Supply levels	Recommended by LEP	'Suitable Risk Management Framework'
1 – Do nothing							
2 – Procure our own energy by direct tender				√	√		
3 – Procure through a Private Sector based provider	√		√	√ In connection with option 4 and 5	√		√
4 – Procure from generators	√ Combined with option 6		√ Combined with option 6	√	√		
5 – Generate own energy			√ Combined with option 6	√ Combined with option 6			
6 – Procure via Central Purchasing Bodies (CPB)	√	√	√	√	√	√	√

10. The council is a member of LEP<sup>2</sup>. Of the 38 other members, approximately 2/3 currently procure energy via LASER and 1/3 are with Crown Commercial Services (CCS).
11. Both, CCS and LASER offer similar procurement only services. Both use a variety of options including “flexible purchase in advance”. Both organisations are recognised as leading public buying organisations. Both identify similar savings and predict similar cost increases.
12. In addition LASER offers fully managed services. Typically these services include bill validation and/or payment, the allocation of invoices against budget codes, managing queries with the supplier, budget forecasting, year-end accruals, consumption reporting, energy monitoring and targeting support. The scope and scale of additional services can be tailored to meet council's business requirements.
13. Detailed benchmarking information is not available publicly for CCS and other Central Purchasing Bodies, so it is difficult to compare them financially.
14. Changing contracts between suppliers is likely to involve a cost and complexity to change – e.g. closing off existing accounts, resolving queries, updating systems, communications with direct payers (schools).

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<sup>2</sup> London Energy Project (LEP) is a public sector shared service, designed and managed by the public sector for the public sector on a not-for-profit basis in total 39 members, including 30 London Authorities and 4 Regional Authorities. Its primary aim is to enable Participating Authorities to achieve value for money and efficiencies through smarter energy buying, improved administration process and carbon reduction.

15. For the new LASER framework, there are two available contract durations:
- Four Year Commitment – 1 October 2016 - 30 September 2020 with no ability to terminate early
  - Rolling Two Year Commitment with an option to issue a termination notice effective after two years have elapsed.

### Preferred route

16. The comparisons demonstrate that joining the CPB would be the best value option. The preferred route is to continue using the energy framework contract established by LASER on the rolling two year basis:
- CCS and LASER offer similar procurement only services. In addition, LASER offers a Fully Managed Service which the council currently uses, costing £0.2m per annum.
  - The Two Year Rolling Commitment with LASER is preferred to the Four Year Commitment as it affords the council flexibility to terminate before September 2020 if it so wishes.
  - Having the option to secure electricity and gas volume for the period October 2016 to September 2020, well in advance of delivery, is vital in protecting LASER customers against potential wholesale market price changes. Negotiation of prices with energy suppliers takes place based on energy supplies worth £350million rather than with just the council's £13 million.
  - 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.
  - The latest independent Value for Money Assessment by the London Energy Project confirms LASER's past purchasing performance to be "Good" (the highest rating).
  - The LEP<sup>3</sup> report (December 2014) evaluated average market price with achieved purchase price and rated LASER's performance as "good" for all four of its purchasing options.
  - LASER has expressed willingness to work with the council to explore options around the purchase of electricity directly from generators, such as through the use of PPAs or sleeving arrangements.
  - LASER is also able to obtain a proportion of the total electricity supply from low carbon and renewable sources on a cost neutral basis. The purchase of such "green electricity" will help support the broad objectives of the Carbon and Energy Policy.

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<sup>3</sup> London Energy Project - Energy Contracts Value for Money Assessment 2011 – 2014, Achieved Prices Benchmark & Risk Assessment Report

- LASER and their suppliers offer added value services such as data collection from Automated Meter Reading (AMR) systems. The suppliers offer services at a discounted rate compared to the prices charged to non-LASER customers and for a cost which is lower than the council could obtain from alternative providers.

The LEP report makes the following recommendation:

*“Given current good levels of performance, OJEU compliant procurement methods and the degree of transparency offered around buying performance, fees and other charges, Participating Authorities may continue using aggregated, flexible, risk managed energy contracts as provided by LASER 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.”*

### **Use of e-Tendering and market management activities**

17. An ‘Open Procedure’ procurement process, in accordance with European Combined Procurement Directive 2004/18/EC, has been utilised by LASER for the tender and award of Flexible Framework Agreements for the supply of Electricity and Gas for the period October 2016 – September 2020.
18. A total of six suppliers submitted tenders (four electricity offers and three gas offers). Npower (electricity) and Total GP (Gas) received the highest assessed tender scores. Npower and Total GP are the incumbent framework providers for electricity and gas respectively.

### **Key Implications**

19. By committing to the supplier recommended for the provision of Flexible purchasing contracts through LASER framework for the period October 2016 – September 2020, on the rolling two year basis, the council will be meeting its duties in managing the risk and ensuring best value for money for this service.
20. Performance of the energy suppliers will be monitored through a series of Key Performance Indicators as detailed in the Framework agreement and reviewed at regular operations meetings with LASER.
21. LASER reports to a Governance Panel each quarter. The panel includes a representative group of LASER customers along with an external expert. The panel reviews LASER’s purchases in the previous quarter, the current purchase positions, LASER’s views on the forward market and LASER’s proposed approach to purchases in the following quarter.
22. The management responsibility for the contracts lies jointly with the Energy Manager for Property Services and Procurement Property Team.

<b><u>CONSULTATION:</u></b>
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23. Key internal stakeholders have been consulted at all stages of the procurement process.

## **RISK MANAGEMENT AND IMPLICATIONS:**

24. Flexible procurement enables the adoption of a robust risk management strategy that can mitigate the price risks inherent in the current energy markets.
25. To maintain an effective risk-management approach, a minimum two-year window is recommended to complete future flexible energy purchases. Without this window, LASER is unable to forward buy energy requirements on behalf of its customers in response to market price changes. To enable LASER to commence purchasing energy requirements from 1 October 2016 onwards, and to take advantage of potential favourable buying opportunities, it is recommended to commit to LASER flexible framework as soon as possible to allow LASER to commence energy purchases on behalf of the Surrey portfolio.
26. Gas and electricity market prices are highly volatile. Market price movements of more than 10% in a week are not unprecedented. Purchasing all energy requirements on a single day therefore carries the risk of buying when energy market prices are high, with a potentially significant associated budget risk. To spread market price risk, and to avoid buying during periods of peak market pricing, the Pan Government Energy Project recommended that “all public sector organisations adopt aggregated, flexible and risk-managed energy procurement” as provided by LASER.
27. LASER has proven its ability to enter the wholesale energy market and to purchase energy and settle contracts at advantageous times. This has resulted in significant saving for local authorities in the South East region.
28. LASER currently offers 2 approaches to managing price risk, or ‘baskets’:
  - a. Purchase In Advance (PIA) in which all energy buying is carried out ahead of the delivery period and so the energy prices remain fixed for a year or more at a time.
  - b. Purchase Within Period (PWP) in which energy buying continues during the delivery period and so the energy prices can vary on a month by month basis
29. The council is able to move supplies between baskets during the Framework Period (Oct 2016 to Sept 2020) providing adequate notice is given.

## **Financial and Value for Money Implications**

30. Significant financial savings have been made on the LASER flexible contract.. SCC achieved savings of £0.7m in 2013/14; £0.6m in 2012/13; £0.6m in 2011/12; £0.8m in 2010/11.
31. Of the £2.7m total savings for the last 4 years, £1m relates to the price compared to the average wholesale market cost and savings of £1.7m were achieved by investing in energy efficiency improvements.
32. Efficiency savings of £0.8M have been built into the Medium Term Financial Plan for 2015/16. It is anticipated that these savings will be achieved through a mixture of both cost savings and energy efficiencies.

33. The current suppliers' (Npower and Total) fees (for the 2012-2016 contract) are £129,415 per annum. For the new framework (2016-2020) the suppliers' annual fees based on current annual usage are estimated to be £53,228 per annum reducing the fees under the new framework by about £76,000 per annum over the duration of the 4-year framework, compared to the previous framework.
34. LASER's own recovery fees for the council buildings, streetlighting and Schools are currently £205,857 per annum based on current consumption. A further appraisal of the Fully Managed and Procurement Only Services may result in a reduction in LASER fees. A reduction in usage through energy saving projects and initiatives will also help reduce LASER fees.
35. Markets will undoubtedly be subject to the continued price volatility as supply/demand fundamentals, geopolitical events and regulatory reform impact prices. Uncertainties surrounding the makeup of future UK electricity generation capacity, along with increasing intermittent renewable generation, will likely increase market price volatility. A flexible and strategic risk managed approach therefore becomes increasingly important to ensure future energy prices are delivered at or below market average prices. This emphasises the need to maintain a forward purchasing window to progressively forward buy energy requirements for the period October 2016 – September 2020.
36. The strategy of joining the LASER flexible framework on the two year rolling basis together with placing a significant minority of the portfolio onto the PWP option will cost effectively manage the risks associated with energy prices.
37. The council's current position is that only the larger supplies in the corporate estate are in the PWP basket while all schools, street lighting and the smaller corporate supplies are in the PIA basket. Moving more supplies into the PWP basket could offer financial savings but these would need to be set against the increased administration required and the needs of stakeholders for budget certainty. The allocation of supplies into baskets will therefore be kept under review to determine whether any further savings can be achieved.
38. Prior to each pricing period, LASER's contracts oblige the suppliers to provide a complete price breakdown for each site showing how all energy and non-energy cost components have been rolled-up into the delivered contract pricing. This ensures that Supplier errors do not translate into higher delivered energy prices.

#### **Section 151 Officer Commentary**

39. The Section 151 Officer confirms that the reported levels of spend are provided for in the council's Medium Term Financial Plan. The current utilisation of the LASER framework has delivered savings to the council when compared with prevailing wholesale market rates. The Section 151 Officer supports the recommendations outlined in this report.

#### **Legal Implications – Monitoring Officer**

40. The operator of the LASER contract, Kent County Council has procured this energy framework through an EU compliant procurement process. By purchasing all its energy requirements through the LASER contract, Surrey County Council is ensuring energy provision is properly procured and fully compliant with EU regulations whilst benefiting from the economies of scale of



this framework contract. In addition, the LASER contract minimises risk to the council.

#### **Equalities and Diversity**

41. LASER is a public sector not-for-profit organisation based wholly in the South East region.
42. There are no material risks for the County council's priorities or Community Strategy.

#### **Climate change/carbon emissions implications**

43. The council attaches great importance to being environmentally aware and wishes to show leadership in cutting carbon emissions and tackling climate change.
44. The council has developed a new Carbon and Energy Policy, approved by Cabinet in March 2015, which includes a target for reducing carbon emissions and several key actions relating to the procurement of energy. LASER's flexible electricity contract contains a provision of cost-neutral renewable electricity for a portion of the total customer requirements. A share of this is allocated to S CC at no price premium. In addition, the contract permits the council to buy additional renewable electricity should it so require. Based on previous experience, it is anticipated that the power purchased on the 2016-2020 LASER framework based on a two year rolling commitment will be generated approximately one-half from low carbon sources such as Good Quality Combined Heat and Power and renewable sources such as biomass, hydro and wind. Although the rules of Greenhouse Gas reporting mean that the purchase of such 'green electricity' does not necessarily reduce the council's carbon footprint directly, it will help support the broad objectives of the Carbon and Energy Policy.

#### **WHAT HAPPENS NEXT:**

45. The timetable for implementation is as follows:

<b>Action</b>	<b>Date</b>
Cabinet decision to award	28 April 2015
Cabinet "call in" period	4 May 2015
Contract Signature	May 2015
Contract Commencement Date (to commence purchases)	May 2015

#### **Contact Officers:**

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**Annexes:**

Annex 1: Flexible Energy Purchasing – Comparison of Procurement Options

**Sources/background papers:**

- LEP Energy Procurement Frameworks – Options Appraisal. December 2014
  - LEP Energy Contracts Value for Money assessment 2011-2014
  - Flexible Energy Frameworks 2016 – 2020 Information Pack
  - LEP Energy Procurement Service Provider Statement of Requirements, October 2011
  - LEP Central Purchasing Body, Statement of Requirements Evaluation, January 2012
  - Definitions of common terms and acronyms used in this report.
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