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|------------------------------------|---|------------------------------|---------------------------------|
| <b>Item No.</b><br>11.             | <b>Classification:</b><br>Open  | <b>Date:</b><br>23 June 2015 | <b>Meeting Name:</b><br>Cabinet |
| <b>Report title:</b>               | Gateway 1 Procurement Strategy Approval: Supply of Gas to all Council Sites |                              |                                 |
| <b>Ward(s) or groups affected:</b> | All wards   |                              |                                 |
| <b>Cabinet Member:</b>             | Councillor Darren Merrill, Environment and the Public Realm                 |                              |                                 |

## **FOREWORD – COUNCILLOR DARREN MERRILL, CABINET MEMBER FOR ENVIRONMENT AND THE PUBLIC REALM**

This report sets out the procurement strategy for the supply of gas for Southwark Council sites.

As every household knows the price of gas has been volatile over the past few years and this can lead to uncertainty. This report sets out how the council, within an approved Framework, can save money working with others to get the best wholesale price of gas; limiting the element of risk to the council. There are a couple of framework providers and this report sets out the strategy and criteria for ensuring the best deal for the council and its tax payers.

### **RECOMMENDATION**

1. That the cabinet approves the procurement strategy outlined in this report for the supply of gas to all council sites, as detailed in paragraph 2 below, at an estimated value of £11.5m per annum for a four year period from 1 October 2016 giving an estimated total value of £46m.

### **BACKGROUND INFORMATION**

2. The council spends approximately £11.5m per annum on gas to provide heating and hot water to the operational estate, leisure centres, libraries, schools and housing estate communal heating systems. A full list of sites supplied with gas under this contract is held as background papers and available on request
3. The council currently contracts with a provider via the LASER framework (LASER is a not-for-profit organisation set up by Kent County Council). The existing contract with LASER and Total Gas and Power (who actually supply the gas) started in October 2012 and runs until 30 September 2016. The contract is a ‘managed solution’ whereby Total Gas and Power sends invoices electronically to LASER who in turn invoice whoever is responsible for paying the bill. This process allows LASER to provide additional services such as basic invoice checking, and to recover their service charge.
4. The current contract has provided excellent value for money to the council with the cost of gas around 42 per cent cheaper than the price available in the retail market. This was calculated within the council’s latest performance report in January 2015, where the council’s average gas cost across its portfolios was 3.09ppkWh, compared to a dual fuel offer from British Gas at 5.34ppkWh.

5. The council has six portfolios for electricity and gas supplies to municipal sites, schools and housing estates. Four of these cover electricity supplies to over 3,500 sites. Two are for the supply of gas to over 200 sites.
6. The portfolios are set up in such a way to provide best value for the council through the length, duration and how the energy is bought. Sites are assigned to each portfolio by their usage and meter type, rather than building type.
7. This report relates to the portfolios that cover the supply of gas to all sites. These are split into larger gas consuming sites including communally heated housing estates, larger schools and key municipal offices, and then all the smaller sites. Although they are separate portfolios, they will essentially be part of the same contract as all the gas will be purchased from the same framework agreement.
8. An EU compliant tender process was used by LASER on behalf of a consortium of authorities including Southwark in 2011. This covered the contract period 2012-2016. A new EU compliant tender is already in place for the period 2016-2020.
9. The existing framework agreement does not have an extension provision beyond 30 September 2016.
10. If purchasing from an organisation that provides a framework agreement the council could join, it needs to share the intended procurement approach with them in a timely fashion to enable them to know the likely amount of gas they will be procuring on our behalf, and to ensure the best price is realised by purchasing ahead of the contract start date.

### **Summary of the business case/justification for the procurement**

11. The council has an on-going need for gas so a new contract is needed from October 2016 to ensure continued provision.
12. This report is proposing a buying method to ensure best value for purchasing gas for sites. Individual contracts will exist between the supplier and whoever is responsible for paying the bills under the framework agreement.

### **Market considerations**

13. The energy market is very competitive and means that consumers in Britain can select from a range of companies to provide their energy supply. The energy suppliers all use the same gas pipes and electricity wires to deliver the same physical products (gas and electricity), so instead they compete on price, service and innovation.
14. The unit (kilowatt hour – kWh) cost of gas to the customer is made up of a number of cost elements:
  - Wholesale cost of the commodity itself – gas or electricity
  - Pass through charges for transporting the energy – i.e. national gas network. These charges are fixed by the energy regulator (Ofgem)
  - Meter operating, billing and administration charges
  - Government taxes – “Climate Change Levy” and VAT
  - Supplier profit.

15. The wholesale price of gas comprises around 60 per cent of the total cost paid by customers. The remaining 40 per cent is made up of the other charges listed above.
16. As the wholesale market price of gas is the dominant factor in the end price to customers, competition between suppliers usually only realises around 1 – 2 per cent difference in prices when tendered.
17. The largest impact on the end gas price is the amount being bought, decision when to buy, and how much future gas demand to buy at any one time (i.e. to cover the total demand for one or two years, or just a portion).
18. The energy market is extremely volatile. Wholesale energy prices are influenced by a range of factors including supply security, weather trends, exchange rates and geopolitical issues. Prices can vary significantly on a daily basis with dramatic rises and falls over a 12-month period. Moves of plus or minus 20 per cent in a single month are possible.
19. Gas prices are likely to increase over the proposed four year contract period. Suppliers will be accounting for infrastructure needs to supply energy, profit, administration costs, regulated fees and taxation.

### **Proposed procurement route**

20. Crown Commercial Service, which was previously known as the Office of Government Commerce (OGC) has estimated that the cost of going through the OJEU process is £30,000. By using an organisation that has a framework agreement in place, as recommended by the London Energy Project (LEP) and OGC, local authorities do not need to go through the tendering process, will no longer have to closely follow the markets, or take difficult decisions over when to buy, thus saving time and money. The decision to be made ultimately is the type of purchasing strategy the council wants to secure within the framework agreement.
21. Further, managing a flexible energy contract is a specialised function, and both the OGC and London Energy Project advise this should only be performed by market specialists with the relevant knowledge, experience and information to undertake this task. Like any other market it requires a ‘trading’ function, deploys tested and continuously improved buying and risk management strategies and has appropriate governance arrangements in place.
22. There are minimum size requirements for buying wholesale energy flexibly, i.e. aggregated to the size of at least ten typical London boroughs so the council would not be able to benefit from wholesale prices unless entering into a framework agreement.
23. There are two organisations operating framework agreements for the supply of gas that the council can join. One is LASER and the other is Crown Commercial Service.
24. LASER is a local government purchasing consortium operating in the South East and London region. It is part of Kent County Council and has responsibility for the energy procurement for the Central Buying Consortium customers as well as for its own customers from London and the South East of England. It represents in excess of 100 authorities.
25. Crown Commercial Service is the national procurement partner for all UK public services and is part of the Efficiency and Reform Group within the Cabinet Office. They have been purchasing aggregated energy volumes via the wholesale markets for more than ten years.
26. The framework procurement process used by both organisations is compliant with Public Contracts Regulations and OJEU.

27. The estimated value of this procurement meets the criteria of EU general protocol, and all reasonable steps would normally have to be taken to obtain at least five tenders following a publicly advertised competitive tendering process through OJEU.
28. This method of purchasing allows the council to access wholesale rather than the retail market prices. This method of buying has been approved and adopted by the council to avoid the risk of effectively settling all of the council's gas costs on a single day through a fixed price, which retrospectively may be a high point in the market. It is also the recognised best practice approach to energy procurement as recommended by Crown Commercial Service and London Energy Project managed by Capital Ambition, the Regional Improvement and Efficiency Partnership.
29. The selected organisation (LASER or Crown Commercial Service) will secure a supplier for gas under the framework agreement and the decision to be made by the council ultimately will be which of these frameworks to join and the type of purchasing strategy it wants to secure from the successful organisation, be that fixed price, or a range of flexible purchasing options. These issues will be considered as part of the Gateway 2 report recommending the framework.
30. The report recommends purchase under a framework agreement in line with best practice.
31. The Gateway 2 report will present best value options available through the two framework agreements available, and also the best value purchasing options within those frameworks. There are a number of factors or criteria that will need to be considered and scrutinised when selecting the framework agreement available which best meets the council's requirements and presents value for money. Selection of the appropriate organisation operating the framework agreement will be made using criteria in the following order:
  1. the tender process used by the organisation offering a framework agreement and evaluation criteria they used for selecting the gas supplier;
  2. how the managed or unmanaged solution offered by each will work and benefits for the authority;
  3. terms and conditions of the framework;
  4. communication with the council, provision of information and how that will be managed;
  5. delegated authority and decision to purchase on behalf of the council. Compatibility with the council's requirements;
  6. the transparency of costs levied under the framework agreement;
  7. provision of information and how it will help the council manage energy consumption throughout the estate;
  8. additional services that can be provided.
32. The energy team will lead and undertake the evaluation, in collaboration with colleagues from procurement, corporate finance and legal services. Records will be kept against the key criteria listed in paragraph 31.
33. Each of the two organisations that offer a framework agreement the council could join will be asked to represent themselves and provide supporting materials to the energy team and will be assessed with professional advice and guidance provided by the OGC and The London Energy Project.
34. The proposed best purchasing solution for the authority's gas supplies contract will be presented at Gateway 2 and will include an assessment of the most suitable approach to

buying the wholesale gas. There are two ways to buy wholesale gas. ‘Purchase in Advance (PIA)’ or ‘Purchase within period (PWP)’

35. PIA means the organisation offering a framework agreement, buys the full estimated gas requirement prior to October each year to be used for a 12 month period. Whilst this approach provides certainty over the price of gas for a full 12 month period, it means that, if the price of gas falls in the period, best value may not be realised.
36. PWP means the organisation offering a framework agreement can either buy the full estimated gas requirement prior to October each year, but only for a six month period, or it can leave some of the requirement to be purchased within the six month period to enable them to take advantage of any falls in the market. Whilst this approach may offer better value for money (if the cost of gas falls in the year) it does not provide certainty over the cost as gas can go up in price as well as down.
37. The two buying options can be likened to a fixed rate or variable rate mortgage where fixed rate gives certainty over the price to be paid but variable rate offers the chance for the price to fall.
38. Officers will recommend a buying solution that presents the best value to the authority utilising expertise from the successful organisation The London Energy Project and independent energy experts where required. The following criteria will be used to help define the selection;
  - Previous PIA and PWP performance demonstrated by the organisation and by further analysing the performance to date in the existing framework where appropriate.
  - Market conditions and gas supply to the UK
  - Market forecast and risk to the authority

### **Identified risks and how they will be managed**

39. The greatest risk in buying gas is in deciding when, and how much volume to purchase. This report sets out how the recommended procurement approach will mitigate this risk by purchasing gas within a flexible framework contract that spreads buying decisions across the contract period. The use of an organisation offering a framework agreement for the supply of gas is also one of the energy procurement solutions recognised as being best practice by central and regional government.
40. Identifying the procurement approach and presenting the findings and the best solution in the Gateway Two report will ensure that the council does not risk making ‘rushed’ decisions without consideration of alternative options.
41. The authority needs to consider the risk in prices fluctuating during the contract periods, and that it feels there is a control over the decisions being made on behalf on the authority by the successful organisation. The selection criteria, including delegated authority for purchasing, in addition to the market analysis (all detailed in the proposed procurement route) will ensure the authority is able to select a solution that allows those risks to be managed.

### **KEY ISSUES FOR CONSIDERATION**

#### **Key/Non Key decisions**

42. This report is a key decision.

## **Policy implications**

43. There are no policy implications.

## **Procurement project plan**

| <b>Activity</b>  | <b>Date completed</b>              |
|--|------------------------------------|
| Forward Plan (if Strategic Procurement)  | 01/04/2015                         |
| DCRB/CCRB/CMT<br>Review Gateway 1: Procurement Strategy Approval                                   | DCRB 28/05/2015<br>CCRB 04/06/2015 |
| <b>Gateway 1:</b> Procurement strategy for approval report (this report)                           | 23/06/2015                         |
| Scrutiny Call-in period and notification of implementation of Gateway 1 decision                   | 01/07/2015                         |
| Council evaluation of framework agreement  | 06/07/2015                         |
| Council evaluation of purchasing solution  | 06/07/2015                         |
| Review Gateway 2: Framework selection and supplier selected by the framework provider award report | DCRB 01/09/2015<br>CCRB 09/09/2015 |
| Notification of forthcoming decision   | 12/09/2015                         |
| <b>Gateway 2:</b> Framework selection Recommendations for purchasing option                        | 23/09/2015                         |
| Start date of council buy-in to the supplier selected by the framework provider                    | 01/10/2016                         |
| Contract completion  | 31/09/2020                         |

## **TUPE implications**

44. There are no TUPE implications.

## **Development of the tender documentation**

45. As the proposal is to join a framework agreement, no tender documentation is needed.
46. Selection of the most suitable framework agreement to join will be based on the criteria set out in Sections 31 and 38 above.

## **Community impact statement**

47. This contract covers gas supplies to central boiler systems which provide heating to smaller housing estates. The estimated increase in gas prices will therefore affect tenants' service charges. However, all sections of the community are equally affected by rising energy prices, whether they have their own domestic boilers (and pay their own gas bills) or are connected to communal systems. The aim of the recommended contract is to adopt a flexible purchasing option whereby falls in the market price for gas can be secured to minimise the overall price to the consumer. This strategy is not an option that is open to individual consumers with their own heating systems.

## **Sustainability considerations**

48. This contract is concerned with securing natural gas supplies to heating systems. As such, there are no sustainable alternatives for this form of supply.

## **Economic considerations**

49. Due to the nature of the energy supply market requirements for suppliers to support local employment would be inappropriate.

## **Social considerations**

50. There are no specific social considerations. The London living wage is not applicable due to the supply nature of this contract.
51. Pursuant to section 149 of the Equality Act 2010 the council has a duty to have due regard in its decision making processes to the need to:
  - Eliminate discrimination, harassment, victimisation or other prohibited conduct
  - Advance equality of opportunity between persons who share a relevant protected characteristic and those who do not
  - Foster good relations between those who share a relevant characteristic and those that do not share it.
52. The relevant protected characteristics are age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, sex, sexual orientation. The Public Sector Equalities Duty also applies to marriage and civil partnership. There are no equality implications associated with this procurement.

## **Environmental considerations**

53. Both organisations will be asked to present the authority with data and any further solutions to manage energy consumption through the council estate. These will be presented in the Gateway 2 report.

## **Plans for the monitoring and management of the contract**

54. The energy team within the environment and leisure department will act as a single point of contact with the supplier to resolve any outstanding queries. Annual performance reviews will be undertaken by the energy team. There will also be a review panel constructed from representatives from organisations utilising the framework that will meet with the framework provider on a quarterly basis to ensure on-going best value. The London Energy Project will also carry out annual reviews on value for money against benchmarked figures.

## **Resource implications**

55. Letting and managing the contract will be undertaken by the energy team. Sufficient resources are in place to ensure effective management

## **Staffing/procurement implications**

56. Client departments are responsible for payment and monitoring of their own invoices. The energy team within environment and leisure will act as a single point of contact with the supplier to resolve any outstanding queries.

## **Financial implications**

57. The estimated contract costs have been based on current wholesale costs and the existing sites utilising the framework agreement.
58. Some sites supplied with gas via this contract will be affected by the changes made as part of the disposals and rationalisation programme to the council estate. Predicted consumption rates for these will be accounted for in the future contract negotiations, in addition to any new sites that may come on board. These changes will be included in the calculations for the estimated contract value and will be updated into the total values prior to the Gateway 2 report.
59. It must be emphasised that this report is recommending a buying method, not a set of fixed gas prices resulting from a competitive tender. All predicted costs are therefore based on current market conditions. The actual billed costs will depend on the purchasing strategy taken and prices of gas secured from the wholesale market.

## **Legal implications**

60. Please see legal concurrent.

## **Consultation**

61. Officers in property and regeneration managing the disposal of council offices and the Modernise Programme will be consulted prior to the contract start date in order to finalise a site listing for the contract.
62. For those schools and leisure centres included in the contract notification will be sent to those responsible for paying the bills of the intention to renew the contract and the period covered.

## **SUPPLEMENTARY ADVICE FROM OTHER OFFICERS**

### **Head of Procurement**

63. This report seeks cabinet approval of the procurement strategy for the supply gas to all council sites. The report identifies two central purchasing bodies that currently buy gas on behalf of local authorities i.e. Buying Solutions and LASER. It is proposed that an assessment of the two procurement vehicles is undertaken to determine which one will secure the best deal for the council.
64. The report details the background to the council's service requirements and to the energy market in particular. When using these procurement vehicles, individual contracts will be agreed between the supplier and the individual clients.
65. The report explains why it is considered that the engagement of a buying consortium will provide the best procurement option for this service and that this approach to gain access to the wholesale rather than retail market is the nationally recognised best practice approach to energy procurement.

- 66. The report confirms the process and the evaluation criteria that will be used to select the preferred buying consortium to be engaged to procure this contract. The key selection criteria are set out and these will form the basis for the recommended option at Gateway 2 stage.
- 67. The total estimated contract value is for a four year contract commencing in October 2016 with no extension provision. The current estimated costs are based on the current energy market predictions whilst the actual costs will depend on the price to be secured from the wholesale market.
- 68. Client departments will be responsible for monitoring their own service and invoices whilst the Energy Team will liaise with the supplier.

#### **Director of Legal Services**

- 69. This report seeks the approval of the proposed procurement strategy in relation to the purchase of electricity supply to all council sites for a period of four years from 1 October 2016.
- 70. The nature and estimated value of this procurement is such that the procurement process will be subject to the full application of the Public Contracts Regulations 2015 ("the EU Regs"). The report advises that there are two organisations (LASER and the Crown Commercial Service) that operate a framework for the supply of electricity which has been (or is currently being) procured in compliance with the EU Regs, and since the council is eligible to use either framework it will not have to carry out its own tendering process. Following approval of this procurement strategy, it is intended that an evaluation of the two consortia framework options will be undertaken using the criteria noted in paragraphs 31 and 38. The outcome of that evaluation will result in a gateway 2 report to seek approval for use of one of the consortia, and to enter into a contract with their supplier.
- 71. This procurement is classed as a strategic procurement under the council's Contract Standing Orders ("CSOs") and therefore CSO 4.4.2 a) reserves to the cabinet or cabinet committee the decision to authorise the proposed procurement process, after consideration by the corporate contracts review board (CCRB) of the report.
- 72. Paragraph 47 contains the community impact statement in relation to the proposed procurement and paragraphs 51 and 52 explain how the council must have due regard to the Public Sector Equality Duty in this procurement. Cabinet should satisfy itself that this duty has been complied with when considering these recommendations. Paragraphs 61 and 62 set out the consultation that has taken place. Cabinet must conscientiously take into account the outcome of consultation when taking a decision on the recommendations in this report.

#### **Strategic Director of Finance and Corporate Services (FC/15/003)**

- 73. The strategic director of finance and corporate services notes the recommendations in this report for the procurement strategy for the supply of gas to all council sites for a four year period from 1 October 2016. The contract will impact on five financial years from 2016/17 to 2020/21.
- 74. At this stage it is not possible to give a firm value for the contract, as the actual billed costs will depend on the purchasing strategy taken and prices of electricity secured from the wholesale market.

75. Once the contract is let, client departments will be responsible for payment and monitoring of their own invoices, and any expenditure must be managed within budget or alternative funding identified. Given the scope of the contract it will impact the council's general fund, housing revenue account, and schools.

#### **Head of Home Ownership**

76. Fuel costs form a substantial part of the costs associated with running the district heating systems, and these costs are service chargeable to those leaseholders who benefit from the system. Although the procurement route is intended to achieve the best price in the market, it does not easily sit within the requirements of the regulations appertaining to Section 20 of the Landlord and Tenant Act, as amended by the Commonhold and Leasehold Reform Act 2002.
77. The proposed contract with a buying consortium is not in itself a qualifying agreement within the terms of the Act, since the management costs associated with the provider are below the consultation threshold. The fuel costs that they will negotiate are above the threshold, however there is no contract between the council and the fuel providers, and the agreements are for periods that are below the 12 month term that falls within the regulations.
78. The council has previously sought dispensation on fuel contracts procured in this way, in order to remove the risk of challenge where the application of the regulations is not clear. The application was made on the basis that all leaseholders were with district heating charges were fully informed of the process by Section 20 Notice, and dispensation was granted where we could not apply all the regulations. Dispensation does not extent to a renewal of these contracts and therefore it will be necessary to serve Notice again, and to seek dispensation on the same terms as before.
79. It is intended to approach the First Tier Tribunal who consider these applications, to seek agreement to make notices available on the website and direct attention to them in the local press, rather than serve the very large number of Notices that are required. It is also intended to seek dispensation that might be extended to future procurements that are in the same terms without making a separate application each time.
80. It will be necessary to obtain the relevant dispensation before an agreement is entered into with the buying consortium.

## BACKGROUND DOCUMENTS

| Background Documents  | Held At  | Contact                                |
|---|--|--|
| Energy Contracts Schedule   | Environmental Services<br>Southwark Council<br>160 Tooley Street<br>London SE1 2QH | Chris Owen<br>Corporate Energy Manager |
| <b>Link:</b><br><a href="http://moderngov.southwark.gov.uk/ieListDocuments.aspx?CId=302&amp;MId=5137&amp;Ver=4">http://moderngov.southwark.gov.uk/ieListDocuments.aspx?CId=302&amp;MId=5137&amp;Ver=4</a> |  |  |
| List of sites supplied with gas under this contract   |  |  |
|   | Environmental Services<br>Southwark Council<br>160 Tooley Street<br>London SE1 2QH | Chris Owen<br>Corporate Energy Manager |
| <b>Link:</b><br><a href="http://moderngov.southwark.gov.uk/ieListDocuments.aspx?CId=302&amp;MId=5137&amp;Ver=4">http://moderngov.southwark.gov.uk/ieListDocuments.aspx?CId=302&amp;MId=5137&amp;Ver=4</a> |  |  |

## AUDIT TRAIL

|   |   |                                       |            |
|---|---|---------------------------------------|------------|
| <b>Cabinet Member</b>   | Councillor Darren Merrill, Environment and the Public Realm |                                       |            |
| <b>Lead Officer</b>   | Ian Smith, Head of Environmental Services                   |                                       |            |
| <b>Report Author</b>  | Chris Owen, Energy Manager                                  |                                       |            |
| <b>Version</b>  | Final   |                                       |            |
| <b>Dated</b>  | 9 June 2015   |                                       |            |
| <b>Key Decision?</b>  | Yes   | If yes, date appeared on forward plan | April 2015 |
| <b>CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER</b> |   |                                       |            |
| <b>Officer Title</b>  | <b>Comments sought</b>                                      | <b>Comments included</b>              |            |
| Director of Legal Services  | Yes   | Yes                                   |            |
| Strategic Director of Finance and Corporate Services                    | Yes   | Yes                                   |            |
| Head of Procurement   | Yes   | Yes                                   |            |
| Head of Home Ownership  | Yes   | Yes                                   |            |
| <b>Contract Review Boards</b>   |   |                                       |            |
| Departmental Contracts Review Board                                     | Yes   | Yes                                   |            |
| Corporate Contracts Review Board  | Yes   | Yes                                   |            |
| <b>Date final report sent to Constitutional Team</b>                    |   | 11 June 2015                          |            |