

Item No. 22.	Classification: Open	Date: 21 June 2011	Meeting Name: Cabinet
Report title:		Gateway 1 Procurement Strategy Approval Supply of gas to sites consuming more than 25,000 therms	
Ward(s) or groups affected:		All	
Cabinet Member:		Councillor Barrie Hargrove Transport, Environment & Recycling	

FOREWORD - COUNCILLOR BARRIE HARGROVE, CABINET MEMBER FOR TRANSPORT, ENVIRONMENT AND RECYCLING

The Council needs to consider the strategy for purchasing the supply of energy to a number of sites across the borough. This report presents an approach for sites consuming more than 25,000 therms.

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. Wholesale prices may increase by up to 50% by 2015. Quite how much and at what point is unknown and they will fluctuate. Prices can vary significantly on a daily basis with dramatic rises and falls over a 12-month period. Moves of plus or minus 20% in a single month are possible. 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 that time (i.e. to cover the total demand for one or two years, or just a portion).

This report recommends the use of a Central Purchasing Body (CPB). As part of a consortium of authorities using this approach Southwark Council will not need to go through the tendering process and will be able to access cheaper gas prices through the wholesale market.

This is a route endorsed by the London Energy Project and the Office of Government Commerce. The Council 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 contract we want to secure from the consortium and the purchasing option adopted within that contract.

RECOMMENDATIONS

1. That the Cabinet approves the procurement strategy outlined in this report for the supply of gas to all sites consuming over 25,000 therms at an estimated value outlined in the closed version of this report.
2. That the Cabinet approves the use of a Consortium contract to award the supply of gas to all sites consuming over 25,000 therms for a four year period from October 2012.

3. That the Cabinet approves the evaluation of the two buying consortia for the award of the contract proposed in this report, namely LASER and Buying Solutions.

BACKGROUND INFORMATION

4. The Council has seven contracts for electricity and gas supplies to municipal sites, schools and housing estates. Four of these cover electricity supplies to over 3500 sites. Three are for supplies of gas to over 200 sites.
5. The contracts are set up in such a way to provide best value for the Council through the length, duration and the specification. Contracts have sites, schools and housing assigned to them dependant on their energy usage and spend. A result of this is that 5 of the contracts run concurrently with LASER (a non-profit making organisation managed by Kent County Council's Commercial Services Department) and expire in September 2012 (see background document – energy contracts schedule).
6. This report relates to the contract that covers the supply of gas to sites consuming over 25,000 therms (equivalent to 732,500 kWh). These are larger gas consuming sites including communally heated housing estates, larger schools and key municipal offices. There are currently 80 sites being supplied in the Council estate.
7. The current flexible contract removes the wholesale cost of energy from the competitive tender process. An EU compliant tender process was used by LASER on behalf of a consortium of authorities including Southwark in 2009.
8. The existing flexible framework agreement with LASER and British Gas started in October 2009 and runs until 30th September 2012. The contract is a managed solution where British Gas 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.
9. It is envisaged that the two sites supplied through the interruptible gas contract will be moved on to this contract after September 2012. The Energy Team are currently investigating the need to have an additional contract for these two sites.
10. Additional sites can be added to the framework once it is set up. For the purpose of this report the 2 sites on the interruptible contract have not been included in any of the calculations.
11. The Energy Team (within the Environment department) have established an energy management database and also receive electronic copies of all energy invoices sent via LASER.
12. British Gas currently calculates a reference price based on market conditions and advance purchases are made on behalf on the consortium. As the actual price will depend on subsequent purchases of gas (under different market conditions) a 'reconciliation' will be made on a six monthly basis. Known as Purchase Within Period (PWP) or Flexible Variable buying occurs both prior to, and during the contract period. This extends the buying window and enables energy to be bought closer to the supply date, taking advantage of any price falls.

13. A risk premium is built in to the reference price and will be set and charged p/kWh. Over the four year period proposed contract period we would receive eight prices each at 6 monthly intervals. The alternative option for purchasing is 'Purchase in Advance'.
14. Purchase in Advance (PIA) or Flexible Locked is where flexible buying occurs prior to the contract supply date. An 'average' price is calculated and locked contract price is provided, thus offering the same budget certainty as fixed-term, fixed-price deals for each supply year. Over the four year contract period we will receive four prices.
15. The Efficiency and Reform group within the Cabinet Office has developed metrics to help assess the performance of wholesale energy purchasing. Graphs in the closed version of this report demonstrate the wholesale purchasing for the period April 2009 to February 2011 against a benchmark of market averages prices achieved over the same period.
16. The estimated annual cost and four year costs (based on the existing contract) is outlined in the closed version of this report.
17. 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. Details are included in the closed version of the report. 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.
18. The existing 'flexible' contract does not have an extension provision owing to its approach via a consortium aggregating the demand of several local authorities.
19. The Council needs to consider procurement timelines for all framework agreements that will be expiring in October 2012, if purchasing from a consortium and using a managed solution. Southwark should provide representation to the consortia of our intended procurement approach by the 30th June 2011. The Council will enter a contract from September 2011 (for the supply period October 2012 to 2016 period) with the chosen consortia if using a flexible managed solution, so they know the likely amount of gas they will be procuring on our behalf, and to ensure the best price is realised.
20. If using an unmanaged solution the 'site' (whoever is responsible for paying the bills) would enter in to an agreement with the supplier. A termination period will be built in to the contract - the standard for most suppliers is 28 days.
21. There is a further urgent need for the Council to identify and gather accurate data for these accounts with the introduction of the Carbon Reduction Commitment (CRC) from 2011/12. The CRC requires the Council to report the carbon emissions resulting from electricity and gas consumption in all Council operational sites, including all schools and academies. In July of 2011, the Council must compile a "Footprint Report" for the financial year 2010/11 which identifies all electricity and gas supplies (to operational sites, schools and academies), and report the annual consumption for each one. Between April and July 2012, the Council will be required to purchase allowances at £12 tonne equivalent to the carbon emissions produced over the financial year 2011/2012.

It is a legal requirement to collect this data and there are significant fines for not presenting the data for sites under the authority's control (£44 tonne). The Energy Team is currently using the gas contract data sent to them from LASER for the sites that are part of the council estate and qualify for inclusion in the CRC (i.e. not housing).

22. This report is for a June 2011 decision.

Summary of the business case/justification for the procurement

23. This contract is a re-tender of an existing requirement for gas supplies to sites consuming over than 25,000 therms.
24. This report is proposing a buying method to ensure best value for purchasing gas for sites consuming over 25,000 therms. Individual contracts will exist between the supplier and whoever is responsible for paying the bills under the framework agreement.
25. Currently there are 80 different sites supplied with gas through the contract.
26. The average contract rate for April 2011 to September 2011 is outlined in the closed version of this report.

Market considerations

27. 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.
28. 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
29. The wholesale price of gas comprises more than 80% of the total cost of paid by customers. The remaining 20% is made up of the other charges listed above.
30. 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 % difference in prices when tendered.
31. 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 that time (i.e. to cover the total demand for one or two years, or just a portion).

32. 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% in a single month are possible.
33. Gas prices will increase over the proposed 4 year contract period. Suppliers will be accounting for infrastructure needs to supply energy, profit, administration costs, regulated fees and taxation. The London Energy Project have also reported that wholesale prices may increase by up to 50% by 2015. Quite how much and at what point is unknown and they will fluctuate.

Proposed procurement route

34. The Office of Government Commerce (OGC) has estimated that the cost of going through the OJEU process is £30,000. By using a Central Purchasing Body (CPB) as recommended by the London Energy Project (LEP) and OGC, local authorities will 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 contract we want to secure from the consortium and the purchasing option adopted within that contract.
35. The framework procurement process used by the consortia is compliant with Public Contracts Regulations and OJEU.
36. The estimated value of this procurement meets the criteria of EU general protocol, and all reasonable steps should be taken to obtain at least five tenders following a publicly advertised competitive tendering process through OJEU.
37. CSO 3.2 advises that this requirement will not apply where the Council intends to purchase under a consortium contract so long as approval for the use of that consortium contract has been given via a gateway one report.
38. This method of purchasing allows the Council to access wholesale rather than the retail market price. 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 the the Office of Government Commerce (OGC) and London Energy Project managed by Capital Ambition, the Regional Improvement and Efficiency Partnership).
39. The CPB will secure a supplier for gas under the framework agreement and decision to be made by Southwark ultimately will be the type of contract we want to secure from the consortium, and the purchasing option adopted within that contract.
40. 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.

41. There are minimum size requirements for buying wholesale energy flexibly, i.e. aggregated to the size of at least 10 typical London boroughs.
42. The London Energy Project, in collaboration with the pan government energy project has evaluated the aggregated, flexible, risked managed contracts provided by the CPBs against a set of best practice criteria. Of those, LASER and Buying Solutions have solutions available to Southwark.
43. 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.
44. Buying Solutions 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 10 years.
45. The report recommends purchase under a consortium contract in line with best practice.
46. The Gateway 2 report will present best value options available through the two consortiums.. There are a number of factors or criteria that will need to be considered and scrutinised when selecting the CPB framework which best meets Southwark's requirements and presents value for money Selection of the consortia will be made using criteria in the following order;
 1. the tender process used by the consortium and evaluation criteria used for selecting the gas supplier;
 2. how the managed or unmanaged solution will work and benefits for the authority;
 3. Service Level Agreement with the consortium, terms and conditions of the framework;
 4. communication with Southwark, provision of information and how that will be managed;
 5. delegated authority, and decision to purchase on behalf of Southwark. Compatibility with Southwark's requirements.
 6. the transparency of costs;
 7. provision of information and how it will help the Council manage energy consumption throughout the estate. This includes the provision of data for the CRC.
 8. additional services that can be provided ;
47. 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 48.
48. Where appropriate, the CPBs will be asked to represent themselves and provide supporting materials to the Energy Team and assessed against professional advice and guidance provided by the OGC and The London Energy Project.

49. Further to this there is a need to evaluate the compatibility of the risk management strategies with the Southwark's financial objectives, an understanding the buying solutions that are used for purchasing energy on the authority's behalf and whether to take a Purchase in Advance or Purchase Within Period contract as detailed in paragraphs 8 to 10.
50. It is proposed that detailed analysis on the risk management strategies and buying solutions proposed by the CPBs will be presented to a representative group from the Council prior to the Gateway 2 report.
51. The proposed best purchasing solution for the authority for the 'gas over 25,000 therms' contract will be presented at Gateway 2. This decision is ultimately whether to take a Purchase in Advance or Purchase Within Period contract as detailed in paragraphs 10 to 12. Council officers will recommend a solution that presents the least risk to the authority utilising expertise from the consortia, 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 consortia and by further analysing the performance to date in the existing contract where appropriate.
 - Market conditions and gas supply to the UK
 - Market forecast and risk to the authority

Options for procurement including procurement approach

52. Prior to the current contract the Council let 'fixed price fixed term' (FPFT) contracts for energy supplies. Typically, these would last for one or two years. This included the supply of gas.
53. For such contracts, suppliers offer a fixed unit price over the contract period. As market prices are highly volatile, contract prices had to be settled on a single day (the tender process would be executed electronically). While the day selected for the tender could be selected according to market conditions, the decision still carried a significant risk of fixing a price for the whole contract volume on one day.
54. In addition, additional procurement costs and officer time needs to be factored in for this approach.
55. As energy markets are so complex it would mean the authority engaging the expertise of a purchasing agent to use market intelligence, to advise on the best time to go to market. For such contracts, suppliers offer a fixed unit price over the contract period typically 1 to 2% cheaper than market prices.
56. FPFT contracts are not an option offered by either of the consortiums evaluated against the pan government criteria.
57. The alternative option is 'do-nothing'. This would effectively leave facility managers at each site to negotiate and secure their own gas suppliers, or remain at an 'off-contract' market rate. This option would present a financial risk to the authority, and the cost of gas supplies would significantly increase if this purchasing route was to be taken.

Identified risks and how they will be managed

58. 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 framework contract that spreads buying decisions across the contract period. The recommended approach is also one of the energy procurement solutions being recommended as being best practice by central and regional government.
59. Identifying the procurement approach, and presenting the findings and the best solution in the Gateway 2 report will ensure that the Council does not risk making 'rushed' decisions without consideration of alternative options.
60. 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 consortia. 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

61. This report is a key decision

Policy implications

62. There are no policy implications.

Procurement project plan

Activity	Date completed
Forward Plan (if Strategic Procurement)	01/06/2011
DCRB/CCRB/CMT Review Gateway 1: Procurement Strategy Approval	DCRB 01/06/2011 CCRB 02/06/2011
Gateway 1: Procurement strategy for approval report (this report)	21/06/2011
Scrutiny Call-in period and notification of implementation of Gateway 1 decision	30/06/2011
Completion of tender documentation	These tasks completed by consortia
Advertise the contract	
Closing date for expressions of interest	
Invitation to tenders	
Closing date for return of tenders	
Completion of evaluation of tenders	
Completion of any post-tender clarification meetings	

Activity	Date completed
Council evaluation of consortia	26/08/2011
Council evaluation of purchasing solution	26/08/2011
Review Gateway 2: Consortia and Contract award report	DCRB 01/09/2011 CCRB 09/09/2011
Notification of forthcoming decision	12/09/2011
Gateway 2: Consortia and contract award approval. Recommendations for purchasing option	23/09/2011
Place award notice in Official Journal of European Union (OJEU)	Completed by consortia
Standstill period observed between award notice and contract award	
Start date of Southwark buy-in to the contract	01/10/2012
Contract completion	31/09/2016

TUPE implications

63. There are no TUPE implications.

Development of the tender documentation

64. Tender documentation for the selection of the supplier is developed and administered by the buying consortia. Evaluation criteria are based on the principle that the wholesale price of electricity is excluded from the tender.

65. It is important to stress that this flexible framework contract is not awarded on the basis of lowest gas price. The gas price will be determined by the wholesale market and the buying decisions made in response to this volatile market.

Community impact statement

66. 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

67. 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

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

Social considerations

69. There are no specific social considerations

Environmental considerations

70. The consortia 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

71. Client departments are responsible for payment and monitoring of their own invoices. The Energy Team within Environment will act as a single point of contact with the supplier to resolve any outstanding queries

Resource implications

72. There are no specific resource considerations

Staffing/procurement implications

73. Client departments are responsible for payment and monitoring of their own invoices. The Energy Team within Environment will act as a single point of contact with the supplier to resolve any outstanding queries

Financial implications

74. The estimated contract costs have been based on current wholesale costs and the existing sites utilising the framework agreement.
75. 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 (included in the closed version of this report). 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.
76. 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 purchasing option taken and prices of gas secured from the wholesale market.

Consultation

77. Officers in Corporate Programmes and Regeneration managing the disposal of council offices and the Modernise Programme were consulted on the timescales and status of disposals and the likely level of occupation of remaining sites.
78. 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

Strategic Director of Communities, Law & Governance (KM0511)

79. This report seeks the approval of the Cabinet to the procurement strategy for the supply of gas (those sites consuming over 25,000 therms) by evaluation of 2 buying consortia - LASER and Buying Solutions. The nature and value of this contract means that this procurement is classed as 'Strategic' under Contract Standing Orders, and therefore the approval of the procurement strategy is reserved to Cabinet.
80. At this value, the contract is also subject to the full application of the EU tendering regulations. However as noted in paragraph 35, both consortia have been subject to an EU compliant process, and either may therefore be used without having to undertake an OJEU advertised tendering process. Following approval of this procurement strategy, an evaluation will be undertaken of the 2 consortia options using the criteria noted in paragraph 48. 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.'

Finance Director (JB0511)

81. This report recommends the use of a consortium contract for the procurement of the supply of gas to all sites consuming over 25,000 therms. The report notes that the energy market is extremely volatile, and that prices can vary significantly on a daily basis. Details are given in the Financial Implications section. The report notes that the GW2 report will be on the basis of either "Purchase within Period" or "Purchase in Advance", taking into account the advantages and risks of each approach.

Strategic Director of Housing Services (LT0511)

82. Statutory consultation will have to be carried out with leaseholders under section 20 of the Landlord and Tenant Act 1985 (as amended), should this contract result in a service charge of more than £100 to any leaseholder in any financial year for the course of the contract. The consultation is a two stage process, with a notice of intention being served pre-tender and a notice of proposal served post tender. Each stage also has a thirty day observation period for leaseholders to make comments, and the next stage of procurement cannot proceed until these periods have been closed.
83. It is likely that the Council will not be able to comply with all the requirements of section 20, and will therefore have to make an application to the Leasehold Valuation Tribunal for dispensation of some part of the regulations. Although a fast track application will be made, asking for a paper hearing only, this process could take several weeks.
84. If the Council does not comply with section 20, or get dispensation for those aspects which cannot be complied with, then service charges to affected leaseholders will be limited to £100 per annum for the lifetime of the contract, which could lead to a significant loss to the Housing Revenue Account, depending on the actual cost of this contract. It is therefore vital that before any procurement strategy is agreed the potential annual cost to leaseholders is identified and any necessary statutory consultation is carried out.

Head of Procurement (MG0511)

85. This report seeks Cabinet approval of the procurement strategy for the supply of gas to all sites consuming over 25,000 therms. 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.
86. 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.
87. 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.
88. 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.
89. The proposed procurement process to be followed by the selected consortia will be compliant with the Public Contracts Regulations and OJEU requirements. The total estimated contract value (detailed in the closed version of this report) is for a four year contract commencing in October 2012 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.
90. Client departments will be responsible for monitoring their own service and invoices whilst the Energy Team will liaise with the supplier.
91. This matter has been reviewed by both the Environment Department Contract Review Board and the Corporate Contract Review Board and recommended changes have been incorporated into this final report.

BACKGROUND DOCUMENTS

Background Documents	Held At	Contact
Energy Contracts Schedule	Sustainable Services Southwark Council 160 Tooley Street London SE1 2QH	Andrew Chandler Sustainable Services Manager

AUDIT TRAIL

Cabinet Member	Councillor Barrie Hargrove, Transport, Environment & Recycling		
Lead Officer	Gill Davies, Strategic Director of Environment		
Report Author	Ian Smith, Head of Sustainable Services		
Version	Final		
Dated	9 June 2011		
Key Decision?	Yes	If yes, date appeared on forward plan	May 2011
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER			
Officer Title	Comments Sought	Comments included	
Strategic Director of Communities, Law & Governance	Yes	Yes	
Finance Director	Yes	Yes	
Head of Procurement	Yes	Yes	
Strategic Director of Housing Services	Yes	Yes	
Contract Review Boards			
Departmental Contracts Review Board	Yes	Yes	
Corporate Contracts Review Board	Yes	Yes	
Date final report sent to Constitutional Team			9 June 2011