

Item No	Classification: OPEN	Date: 17 June 2011
To	Cabinet Member for Transport, Environment and Recycling	
Report title	Gateway 1 Procurement Strategy Approval Supply of electricity to maximum demand sites	
Ward(s) or groups affected	All	
From	Strategic Director of Environment	

RECOMMENDATIONS

1. That the Cabinet Member for Transport, Environment and Recycling approves the procurement strategy outlined in this report for the supply of electricity to maximum demand sites.
2. That the Cabinet Member for Transport, Environment and Recycling approves the use of a Consortium contract to award the supply of electricity to maximum demand sites for a four year period from October 2012.
3. That the Cabinet Member approves the evaluation outlined in this report 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.
6. This report relates to the contract that covers the supply of electricity to maximum demand sites. These are monthly billed sites for which there is a charge for the maximum electrical capacity demand at the site, in addition to the usual unit charge (per kWh of consumed electricity). The Council currently has 49 different sites on the contract.
7. The current flexible contract for maximum demand sites also 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 NPower started in November 2008 and runs until 30th September 2012. The contract is a managed solution where NPower 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. 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.

10. In addition the contract is performance managed for housing sites by way of the energy team checking bills against contractor readings supplied by OCO Limited and T Brown. Engineering services operate and performance manages the contract with OCO and T Brown, and takes up any issues raised with regards to inaccurate or missing readings.
11. NPower currently purchase portions of energy from the wholesale market on behalf on the consortium in blocks of 10MWh (mega Watt hours). This is defined as 'Purchasing In Advance' according to a pre-defined risk management strategy and anticipated electricity requirements. The alternative option for purchasing is 'Purchasing Within Period'.
12. 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.
13. Purchase Within Period (PWP) or Flexible Variable is where flexible buying occurs both prior to and during the contract period. This extends the buying window, allowing more opportunities for buying at optimal times and enables energy to be bought closer to the supply date, taking advantage of any price falls. An indicative price is provided at the start of the contract and price reconciliations will be undertaken at the end of each year on the anniversary. On top of the reference price a risk premium will be set and charged p/kWh. Over the four year period we will receive eight prices each at 6 monthly intervals.
14. The Efficiency and Reform group within the Cabinet Office has developed metrics to help asses 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 achieved over the same period.
15. The estimated annual cost and four year costs (based on the existing contract) is outlined in the closed version of this report.
16. Some sites supplied with electricity 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 this report. Predicted consumption rates for these will be accounted for in the future contract negotiations, in addition to any new sites that we may want to be include. 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.
17. The existing 'flexible' contract does not have an extension provision owing to its approach via a consortium aggregating the demand of several local authorities.
18. The Council needs to consider procurement timelines for all contracts that will be expiring in September 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) with the chosen consortia if using a flexible managed solution so they know the likely amount of electricity they will be procuring on our behalf, and to ensure the best price is realised.
19. 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.

20. 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 data sent to them from LASER for the 49 sites on this contract.

21. This report is for a June 2011 decision.

Summary of the business case/justification for the procurement

22. This contract is a re-tender of an existing requirement for the supply of electricity to maximum demand sites.

23. This report is proposing a buying method to ensure best value for purchasing electricity for the highest consuming sites in the borough. Individual accounts will exist between the supplier and whoever is responsible for paying the bills under the framework agreement.

24. Currently there are 49 different sites supplied with electricity on the contract. Details are included in the closed version of this report.

25. Sites included in the contract will be required to consider the terms and conditions set out by the consortia. This includes the time frames and notice period required. Details of how this will be administered and managed by the Council will be presented in the Gateway 2 report.

26. The average contract rate for October 2010 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. Regional distribution network operators are responsible for transporting electricity along their networks via a network of cables and wires known as 'the grid'. Charges for the supply are included on costs passed on to the customer from the suppliers.

29. As such, the unit (kilowatt hour – kWh) cost of electricity 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, national electricity grid. These charges are fixed by the energy regulator (Ofgem)
- Meter operating, billing and administration charges
- Government taxes – "Climate Change Levy" and VAT
- Supplier profit

30. The wholesale price of electricity comprises around 70% of the total cost of paid by customers. The remaining 30% is made up of the other charges listed above.
31. As the wholesale market price of electricity is the dominant factor in the end price to customers, competition between suppliers usually only realises around 1 – 2 % difference in prices when tendered.
32. The largest impact on the end electricity price is the amount being bought, decision when to buy, and how much future electricity demand to buy at that time (i.e. to cover the total demand for one or two years, or just a portion).
33. The energy market is extremely. 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 (set on a half hourly basis for electricity) with dramatic rises and falls over a 12-month period. Moves of plus or minus 20% for the wholesale electricity cost in a single month are possible.
34. Electricity 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

35. The Office of Government Commerce (OGC) has estimated that the cost of going through the OJEU process is £30,000 for purchasing energy contracts. 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
36. The framework procurement process used by the consortia is compliant with the Public Contracts Regulations and OJEU.
37. The estimated value of this contract and it's procurement is subject to EU procurement regulations and a competitive tendering process through OJEU.
38. CSO 3.2 allows the Council intends to purchase under a consortium contract so long as for the use has been given via the gateway one report.
39. 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 electricity 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).
40. The CPB will secure a supplier for electricity to maximum demand sites 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.

41. 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.
42. There are minimum size requirements for buying wholesale energy flexibly, i.e. aggregated to the size of at least 10 typical London boroughs.
43. 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 key best practice criteria. Of those, LASER and Buying Solutions have solutions available to Southwark.
44. 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.
45. 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.
46. The report recommends purchase under a consortium in line with best practice.
47. 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 and the framework which best meets Southwark's requirements and offers best value for money. Selection of the consortia will be made using criteria in the following order;
 1. the tender process used by the consortia and evaluation criteria used for consortia when selecting electricity 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 and 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;
48. The Energy Team will lead and undertake the evaluation, in collaboration with colleagues from the Head of Procurement for Environment, Corporate Finance and advise sought from Legal Services. Records will be kept against the key criteria listed in paragraph 47.
49. 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.
50. Further to this there is a need to the evaluate the compatibility of the risk management strategies with the Southwark's financial objectives, an understanding of 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 10 to 12.

51. 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.
52. The proposed best purchasing solution for the authority for half hourly metered sites will be presented at Gateway 2 stage. The 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

53. 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 electricity to maximum demand sites.
54. 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.
55. In addition, additional procurement costs and officer time needs to be factored in for this approach.
56. 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.
57. FPFT contracts are not an option offered by either of the consortiums evaluated against the pan government criteria.
58. The alternative option is 'do-nothing'. This would effectively leave facility managers at each site to negotiate and secure their own electricity suppliers, or remain with NPower 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

59. The greatest risk in buying electricity 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 electricity 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.

60. 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.
61. The authority needs to consider the risk in prices fluctuating during the contract periods, and of not having 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

62. This report is a non-key decision.

Policy implications

63. There are no policy implications.

Procurement project plan

Activity	Date completed
Forward Plan	01/06/2011
DCRB/CCRB Review Gateway 1: Procurement Strategy Approval	DCRB 07/06/2011 CCRB 09/06/2011
Publication of of Gateway 1 decision	June 2011
Gateway 1: Procurement strategy for approval report (this report)	June 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	
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 08/09/2011
Publication of Gateway 2 decision	12/09/2011
Gateway 2: Consortia and contract award approval. Recommendations for purchasing option	09/09/2011
Call-in period and notification of implementation of Gateway 2 decision	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	

Activity	Date completed
Start date of Southwark buy-in to the contract	01/10/2011
Start date of Southwark buy-in to the supply contract	01/10/2012
Contract completion	30/09/2016

TUPE implications (if no TUPE implications write ‘not applicable’)

64. There are no TUPE implications.

Development of the tender documentation

65. 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.

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

Community impact statement

67. This contract includes electricity supplies to housing estate district heating systems (largely to power pumps). While these electricity costs represent a small proportion of the overall heating costs to tenants and leaseholders, this procurement route is recommended to achieve the minimum electricity prices.

Sustainability considerations

68. Suppliers will offer prices for electricity generated via renewable energy sources (‘green’ electricity). However, it is not recommended that the Council opt for such green supplies if these cost more than the lowest standard electricity offers. The Council cannot claim to achieve further CO₂ reductions through such contracts. Moreover, it must be highlighted that the council will not be able to claim zero CO₂ emissions for such “green tariff” supplies under the Carbon Reduction Commitment scheme.

Economic considerations

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

Social considerations

70. There are no specific social considerations

Environmental considerations

71. 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

72. 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
73. In addition the contract will be performance managed for housing sites by way of the energy team checking bills against contractor readings supplied by OCO Limited and T Brown. Engineering services operate and performance manages the contract with OCO and T Brown, and takes up any issues raised with regards to inaccurate or missing readings

Resource implications

74. There are no specific resource implications.

Staffing/procurement implications

75. No additional implications.

Financial implications

76. The estimated contract costs have been based on current wholesale costs and the existing sites utilising the framework agreement.
77. Some sites supplied with electricity 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 we may want to include. 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.
78. It must be emphasised that this report is recommending a buying method, not a set of fixed electricity 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 electricity secured from the wholesale market.

Legal implications

79. Please see legal concurrent.

Consultation

80. 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.
81. 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 (KM0611)

82. This report seeks the approval of the Cabinet Member for Transport, Environment and Recycling to the procurement strategy for the supply of electricity to maximum demand sites by evaluation of 2 buying consortia - LASER and Buying Solutions. In accordance with Contract Standing Order 4.4.2(b) the approval of this procurement strategy is a decision reserved to the relevant individual decision maker, due to its value being above £2 million but below £4 million.
83. At this value, the contract is also subject to the full application of the EU tendering regulations. However as noted in paragraph 38, 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 49. 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 (JB0611)

84. This report recommends the use of a consortium contract for the procurement of the supply of electricity to maximum demand sites. 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.

Director of Housing (MG0611)

85. 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.
86. 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.
87. 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 (MG0611)

88. This report seeks Cabinet approval of the procurement strategy for the supply of electricity to maximum demand sites. The report identifies two central purchasing bodies that currently buy electricity 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.
89. 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.
90. 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.
91. 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.
92. 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 is detailed in the closed version of this report 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.
93. Client departments will be responsible for monitoring their own service and invoices whilst the Energy Team will liaise with the supplier.
94. 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, SE1	Andrew Chandler Sustainable Services Manager 0207 525 3804

APPENDICES

No.	Title
1	Energy Supply Contracts May 2011

AUDIT TRAIL

Lead Officer	Gill Davies, Strategic Director of Environment		
Report Author	Ian Smith, Acting Head of Sustainable Services		
Version	Final		
Dated	17 June 2011		
Key Decision?	No	If yes, date appeared on forward plan	
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	
Director of Housing	Yes	Yes	
Cabinet Member	Yes	Yes	
Date final report sent to Constitutional Team	17 June 2011		

BACKGROUND DOCUMENT – CONTRACTS REGISTER ENTRY FORM – GATEWAY 1

Mandatory : Please complete the following details:

Contract Name	Supply of electricity to maximum demand sites
Contract Description	
Contract Type	Supplies
Fixed Price or Call Off	
Contract Lead Officer (name)	Andrew Chandler
Contract Lead Officer (phone number)	020 7525 2402/3804

Department	Environment
Division	Sustainable Services
Business Unit	Energy Management
Procurement Type	
Procurement Route	
Coverage	Borough-wide
Gateway 1 Approval Date	June 2011
Estimated Tender Start Date	NA
Estimated Gateway 2 Date	September 2011
Estimated Contract Value	£2,680,000

OPTIONAL: If available, please complete the following details:

Services/Supplies/Works Contract – delete as appropriate. EU CPV Code – if appropriate and available	Not available
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