

Item No. 12.	Classification: Open	Date: 16 July 2013	Meeting Name: Cabinet
Report title:		Gateway 1: Procurement Strategy Approval - Supply of Electricity to Quarterly Billed Sites	
Ward(s) or groups affected:		All wards	
Cabinet Member:		Councillor Barrie Hargrove, Transport, Environment and Recycling	

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

The Council has to buy electricity and gas for use in its offices, schools, housing stock and street lighting. We currently have six contracts in place, two for gas and four for electricity. Sites are assigned to one of these contracts depending upon the amount of energy consumed and this ensures the best available prices are obtained.

Five of these contracts are already with Laser buying consortium, managed by a team within Kent County Council.

The quarterly billed electricity contract is due to expire on 31 March 2014 and this report recommends that Laser are chosen to be the new provider as it is believed that this will be the most advantageous approach for both the Council and the residents within the Borough.

After some extensive work across the Council, gathering the required data associated with the 3500 sites contained within this portfolio, we are now in a position to be able to let the contract in line with the best practise route taken with the other five.

The five portfolios previously secured on this type of contract arrangement are already realising large savings of around £6m across the Council when compared to the prices available for gas and electricity in the retail market. These savings benefit Housing estates, schools, offices and depots and support our fairer future principle of 'spending money as if it were coming from our own pocket'.

The outlined procurement strategy will also enable us to measure progress against the Council's Energy and Carbon Reduction Strategy, agreed by Cabinet in September 2011, by providing key data and information about energy usage across the Council, helping us monitor and subsequently reduce our carbon footprint.

RECOMMENDATIONS

1. That the Cabinet approves the use of the Laser consortium arrangement for the purpose of purchasing the supply of electricity to quarterly billed sites for a period of two years and six months from 1 April 2014 to 30 September 2016, at an estimated cost of £4.37m per annum, totalling an estimated cost of £10.9m.

2. That the cabinet delegates authority to the strategic director of environment and leisure to award the contract and agree the purchasing options to be outlined in the gateway 2 report.

BACKGROUND INFORMATION

3. 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 supplies of gas to over 200 sites.
4. Following an extensive procurement exercise during 2011/12, it was decided that Laser Buying Group (a central purchasing body set up by Kent County Council) offered the best value for money and service in comparison with the Government Procurement services framework for the supply of gas and electricity to Southwark Council. Therefore four of the portfolios joined the Laser flexible framework agreement running from October 2012 to September 2016 when their existing contracts ended. The suppliers within this framework agreement are currently Total Gas and Power for Gas and Npower for electricity. These were elected by Laser following a full Office Journal of the European Union tender process during 2011.
5. The two portfolios that did not join at this time were already in other contract arrangements that could not be terminated. These were:
 - Two sites on an interruptible gas supply framework agreement with Government Procurement Services that expired on 31 March 2012. These have subsequently joined the large gas consumption portfolio with Laser.
 - The quarterly billed electricity sites that are in a fixed term contract with EDF until 31 March 2014.
6. Approval is sought for this additional portfolio of quarterly billed accounts to join this same purchasing strategy with Laser once its current contract finishes.

Summary of the business case/justification for the procurement

7. This contract covers the supply of electricity to quarterly billed sites. The supplies on this contract are the lowest electricity consuming sites. There are currently 3,437 individual supply accounts currently on this contract. The majority of these accounts are for landlord electricity supplies (e.g. stairway lighting) to housing estates. However, the contract also includes a wide range of other supplies, from primary schools and small municipal offices to market stall supplies at East Street.
8. This report is proposing a buying method to ensure best value for purchasing electricity for the smallest consuming sites in the borough.
9. The current contract is a fixed term, fixed price contract with EDF and expires on 31 March 2014.

Market considerations

10. 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 cables to deliver the same

physical products (gas and electricity), so instead they compete on price, service and innovation.

11. 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.

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
12. The wholesale price of electricity comprises around 70 per cent of the total cost paid by customers. The remaining 30 per cent is made up of the other charges listed above.
 13. 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 per cent difference in prices when tendered.
 14. 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).
 15. 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 (set on a half hourly basis for electricity) with dramatic rises and falls over a 12-month period. Moves of plus or minus 20 per cent for the wholesale electricity cost in a single month are possible.
 16. Electricity prices will increase over the proposed two and a half year contract period. Suppliers will be accounting for infrastructure, needs to supply energy, profit, administration costs, regulated fees and taxation.
 17. A flexible procurement approach helps to negate sudden price rises by forward purchasing and trading on the wholesale market.

KEY ISSUES FOR CONSIDERATION

Options for procurement route including procurement approach

18. Historically, this particular portfolio of sites has been negotiated directly with EDF as fixed term, fixed price as the incumbent supplier. This is due to a number of factors, most prominently the fact that this option was the best value on a site by site basis. This is because the procurement cost per meter was lower, and with

the sites consuming less volume, this factor had a larger bearing on the overall outturn price. This option was removed from availability after January 2011.

19. Due to the nature of the types of supplies (low usage, large volume of meters); the council did not hold enough information to be able to tender them effectively. Information such as Meter Point Administration Numbers, and even locations of the supplies was not complete in some cases. Following a full survey carried out by the housing department during 2010/11, all meters within the contract were identified, and listed against location. This information can now be given to the suppliers to be able to tender effectively.
20. To comply with current procurement legislation, contracts with a value over £173,934 are advertised to the whole of the EU via the Official Journal of the European Union. Southwark's Quarterly billed electricity contract exceeds this value. On this basis, we are obliged to tender the contract from renewal.
21. Laser, a central purchasing body created by Kent County Council, has a framework agreement in place that is specifically tailored to the supply of electricity to quarterly-billed sites. The framework contains a single-supplier for the period 1 April 2014 to 30 September 2016 (aligning with Laser's existing flexible supply baskets). To best-suit the typically low usage per supply point for quarterly-billed supplies, the framework will seek to minimise ongoing supplier, Laser and customer administration.
22. Large financial savings have been made by the council since utilising the framework agreements with Laser. Annual performance reports for the contracts already with Laser, presented in February 2013, showed that the prices being achieved were almost 25% less than those obtainable directly from the retail market. This saving is passed directly on to leaseholders, tenants, schools and the council, and provides evidence to support the use of the procurement route outlined in this report.
23. Fixed term, fixed price supply contracts are no longer an option offered by either of the consortiums evaluated against the pan government criteria. Therefore a flexible procurement strategy is recommended.
24. 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 EDF at an 'off-contract' market rate which is generally around twice the price of contracted rates. This option would present a financial risk to the authority, and the cost of these electricity supplies would significantly increase if this purchasing route was to be taken.

Proposed procurement route

25. The Office of Government Commerce (now Government Procurement Services), has estimated that the cost of going through the OJEU process is £30,000. By using a Central Purchasing Body as recommended by the London Energy Project and the Office of Government Commerce, local authorities do not need to go through the tendering process, and no longer have to closely follow the markets, or take difficult decisions over when to buy, thus saving time and money
26. The framework procurement process used by the consortia is compliant with the current EU procurement regulations.

27. With an estimated value of £10.9M for a two year and six month contract, this procurement meets the criteria of EU general protocol, and that all reasonable steps should be taken to obtain at least five tenders following a publicly advertised competitive tendering process.
28. 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 1 report. A gateway 2 report will be presented showing the procurement costs, together with the recommended purchasing strategy, and estimated contract value.
29. 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 may coincide with a high point in the market.
30. Laser will secure a supplier for electricity to quarterly billed sites under the framework agreement and the 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. This will be presented via a gateway 2 report.
31. Managing a flexible energy contract is a specialised function, and both the Office of Government Commerce 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.
32. There are minimum size requirements for buying wholesale energy flexibly, i.e. aggregated to the size of at least ten typical London boroughs.
33. The London Energy Project, in collaboration with the pan government energy project has evaluated the aggregated, flexible, risk managed contracts provided by the Central Purchasing Bodies against a set of key best practice criteria. Of those, Laser and Government Procurement Services have solutions available to Southwark.
34. 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 of 120 organisations, including Local authorities; of which 24 are London Boroughs.
35. Government Procurement Services 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.
36. A full gateway process during 2011 and 2012 presented the best value option available through the two consortiums. There were a number of factors or criteria that needed to be considered and scrutinised when selecting the Central Purchasing Body and the framework which best met Southwark's requirements

and offered best value for money. Selection of the consortia was made using the following criteria and is available in the background document listed;

- the tender process used by the consortia and evaluation criteria used for consortia when selecting electricity supplier;
 - how the managed or unmanaged solution will work and benefits for the authority
 - Service Level Agreement with the consortium, terms and conditions of the framework;
 - communication with Southwark, provision of information and how that will be managed;
 - delegated authority, and decision to purchase on behalf of Southwark and compatibility with Southwark's requirements;
 - the transparency of costs;
 - provision of information and how it will help the council manage energy consumption throughout the estate. This includes the provision of data for the council's carbon reduction commitment scheme return.
 - additional services that can be provided;
37. The Energy Team led and undertook the evaluation, in collaboration with colleagues from departmental procurement, corporate finance and legal services. Records were kept against the key criteria listed in paragraph 36.
38. The Central Purchasing Bodies were asked to represent themselves and provide supporting materials to the Energy Team and assessed against professional advice and guidance provided by the Office of Government Commerce and The London Energy Project.
39. Further to this there was a need to evaluate the compatibility of the risk management strategies with 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.
40. Having demonstrated Laser as being the best option both financially and also from a customer service aspect for the other five portfolios of sites during the most recent procurement process, it is proposed that the quarterly billed portfolio of sites join the flexible framework agreement with Laser, thus aligning all portfolios of energy supplies until September 2016.
41. The proposed best purchasing solution for the authority for these particular electricity supplies will be presented at Gateway 2.

Identified risks for the procurement

42. The greatest risk in buying electricity is in deciding when, and how much 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.
43. Identifying the procurement approach, and presenting the findings and the best solution in the previous gateway 2 report has ensured that the council have not

taken any risk making ‘rushed’ decisions without consideration of alternative options. Further analysis of the available purchasing options within the framework will be presented in the gateway 2 report for this contract.

44. Officers have considered the risk of prices fluctuating during the contract periods, and are satisfied that there is a control over the decisions being made on behalf of the authority by the consortium. The selection criteria, including delegated authority for purchasing, in addition to the market analysis (all detailed in the procurement route) has ensured the authority is able to select a solution that allows those risks to be managed.

Key /Non Key decisions

45. This report is a key decision.

Policy implications

46. There are no policy implications.

Procurement Project Plan (Key Decisions)

Activity	Complete by:
Forward Plan (if Strategic Procurement)	28/03/2013
DCRB/CCRB/CMT Review Gateway 1	23/05/2013 DCRB 06/06/2013 CCRB
Notification of forthcoming decision – despatch of Cabinet agenda papers	4/7/2013
Approval of Gateway 1: Procurement strategy report	16/07/2013
Scrutiny Call-in period and notification of implementation of Gateway 1 decision	26/07/2013
Issue Notice of Intention	
Completion of tender documentation	These tasks are completed by Laser
Advertise the contract	
Closing date for expressions of interest	
Completion of short-listing of applicants	
Invitation to tender	
Closing date for return of tenders	
Completion of any interviews	
Completion of evaluation of tenders	Completed by Laser
Issue Notice of Proposal	Completed by Laser
Forward Plan (if Strategic Procurement)	31/7/2013
DCRB/CCRB/CMT Review Gateway 2:	15/8/2013 22/8/2013
Notification of forthcoming decision – despatch of Cabinet agenda papers	tbc
Approval of Gateway 2: Contract Award Report	tbc
Scrutiny Call-in period and notification of implementation of Gateway 2 decision	tbc

Alcatel Standstill Period (if applicable)	N/A
Contract award	N/A
Activity	Complete by:
TUPE Consultation period	N/A
Place award notice in Official Journal of European Union (OJEU)	completed by consortia
Contract start	1/04/2014
Contract completion date	30/09/2016
Contract completion date – (if extension(s) exercised)	N/A

TUPE/Pensions implications

47. There are no TUPE implications.

Development of the tender documentation

- 48. Tender documentation has been developed and administered by the buying consortia.
- 49. 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.

Advertising the contract

50. This task has been completed by the Central Purchasing Body (Laser).

Evaluation

51. This task has been completed by Laser.

Community impact statement

- 52. This contract includes electricity supplies to housing estate lighting in stairwells and lifts. 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.

Economic considerations

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

Social considerations

54. There are no specific social considerations

Environmental considerations

- 55. The buying consortia purchases green energy generated by the supplier from renewable sources where available, typically around 10% of the electricity purchased is currently produced from renewable sources.

Plans for the monitoring and management of the contract

56. Client departments are responsible for payment and monitoring of their own invoices. 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.
57. An annual performance report for this contract will be presented to DCRB and CCRB by the energy team.

Staffing/procurement implications

58. There are no additional staffing implications than those already set up to look after the current contracts.

Financial implications

59. The estimated contract costs have been based on current wholesale costs and the existing sites utilising the framework agreement.
60. Some sites supplied with electricity via this contract will be affected by the changes made as part of the disposals and rationalisation programmes to the council estate, and may result in some fluctuations to the total contract price. 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.
61. 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 the purchasing option taken and prices of electricity secured from the wholesale market.
62. The future contract costs are difficult to predict as the previous contract was on a fixed term, fixed price tariff since 2011. In this instance, the supplier would give a fixed price at the start of the contract that built in price rises for the duration of the contract. The flexible approach negates the risk of fixing a four year price on one single day and has proved to be best value when comparing contracts.
63. The below table indicates an estimated breakdown of the sources of funding;

Budget	Annual costs for 2011/12-13/14	Predicted annual costs from 2014/15	Increase from current
HRA	£3,494,387	£3,669,106	£174,719
General fund	£451,656	£474,239	£22,583
Schools	£428,665	£450,098	£21,443
Total	£4,374,708	£4,593,443	£218,735

The increases shown are based on the assumption that the exact same number of sites will still be on this contract and an estimated increase of 5% on prices by April 2014.

64. The major risk areas involved in the procurement strategy being recommended have already been highlighted in paragraphs 42 to 44. Those risk areas relating to when to buy and the volume to purchase, are mitigated by the purchase of electricity within the framework contract and allows buying decisions to be taken across the contract period. This approach also mitigates any additional risk that could arise through rushed decision making without consideration of alternative options. The use of the framework contract also allows the authority control over the decisions being made on its behalf by the consortia, as part of the selection criteria, including delegated authority and market analysis, during the procurement stage.
65. The budget available within the Housing Revenue Account for 2013/14 is £3,822,890 and this consists of £645,003 for the Heating Account and £3,177,887 for the remainder of the contract. This should cover the predicted annual costs contained within the table above. The budget available to the Housing General fund for 2013/14 is £102,405, but this sum will form only part of the overall General Fund budget available. The remaining General Fund budgets are held and managed under the respective service areas. Annual price variations of all energy budgets (based on current best estimates at the time) are given to the Finance and resources team during the budget setting process. These budgets are adequate to cover the costs of the contract.

Investment implications

66. There are no implications regarding investment.

Legal implications

67. Please see concurrent from the director of legal services.

Consultation

68. Please see concurrent from the head of specialist housing services.

Other implications or issues

69. N/a

SUPPLEMENTARY ADVICE FROM OTHER OFFICERS

Head of Procurement

70. This gateway 1 report is seeking approval to utilise the Laser consortium arrangement to purchase the supply of electricity to quarterly billed sites. This report is also seeking delegated authority for the gateway 2 report which will follow.
71. The report confirms that the council joined the Laser consortium following an extensive procurement exercise during 2011/12. Six of the council's seven electricity and gas portfolios are now secured through this consortium. The remaining portfolio, electricity to quarterly billed sites, is the subject of this report.

72. With the expiry of the current contractual arrangement for quarterly billed sites, there has been an opportunity to review the procurement options. Paragraphs 18 to 24 outline the procurement options that were considered and discounted.
73. The report confirms that by using the Laser consortium arrangement, the council has previously made financial savings and received a good level of customer service. It is expected therefore that this proposed procurement route will continue to secure the best deal for the council.
74. The Laser consortium offers flexibility in the way electricity can be purchased through this arrangement. Paragraph 29 confirms that the gateway 2 report will contain recommendations in relation to the purchasing options, the estimated contract value and procurement costs.

Director of Legal Services

75. This report seeks cabinet approval of the procurement strategy for the purchase of electricity supply to quarterly billed sites within the borough through the LASER purchasing consortium (described in paragraph 34). The director of legal services (acting through the corporate team) has advised officers in connection with this matter and notes the content of this report.
76. In view of the estimated cost of the electricity supply for the council's sites the procurement process is governed by the requirements of the EU Procurement Regulations which include a call for expressions of interest by way of the publication of a contract notice in the Official Journal of the European Union ("OJEU"). The report confirms that the framework agreement established and administered by LASER for the purchase of this type of electricity supply is compliant with those Regulations.
77. The procurement is also subject to the application of the council's Contract Standing Orders ("CSOs"). CSO 3.2 provides that "approval to create or join a purchasing consortium must be obtained in a Gateway 1 report which must identify the procedure for award of individual contracts or orders placed by the consortium. Once approval has been obtained, contracts or orders placed through the purchasing consortium will not be subject to the tendering or quotation requirements in CSOs, but the usual Gateway 2 procedures must be followed". Paragraphs 28 to 30 advise that the details of the purchases to be made by LASER on behalf of the council will be presented in a Gateway 2 report at a later date.
78. Paragraph 68 summarises the council's statutory obligations in relation to leaseholder consultation in connection with the proposed procurement and the steps which are to be taken to satisfy those obligations.
79. The proposed procurement strategy is defined as a strategic procurement under CSOs, and as such the decision to approve it is one which must be taken by the Cabinet, after consideration of the report by the Corporate Contract Review Board.

Strategic Director of Finance and Corporate Services (FC13/044)

80. This report seeks approval of a consortium arrangement for the purpose of purchasing the supply of electricity to quarterly billed sites 1 April 2014.

81. The strategic director of finance and corporate services notes the finance implications detailed in paragraphs 59 and 65 showing that costs will be contained within the existing budget. Any increases in price from 2014/15 and beyond will need to be identified during the annual budget setting process.
82. The cost of resources to implement this contract will be contained within current budgets.

Head of Specialist Housing Services (For Housing contracts only)

83. The majority of the quarterly billed accounts are for the landlord supply to council housing estates, and the costs are service chargeable to leaseholders under the terms of the lease. Because the costs are frequently in excess of £100 per annum to individual leaseholders, and because the contract is for a term in excess of 12 months, the contract is considered to be a qualifying long term agreement under the terms of the Commonhold and Leasehold Reform Act 2002 and consultation is required under schedule 2 of the regulations.
84. A notice under S20 of the Landlord and Tenant Act 1985 (as amended) that covers some of the requirements of the regulations was served on all leaseholders in the borough on 25th May 2013. The observation period expires on 1st July 2013. The notice does not comply with the requirements of the regulations because the contract will not be offered for tender and because it is not possible in advance to identify the unit rate per kilowatt hour. In order to protect the council's ability to recover service charges in these circumstances an application has been made to the Leasehold Valuation Tribunal for dispensation from the consultation requirements. The hearing is scheduled for 27th June 2013. Previous applications of this nature have been made to the LVT and dispensation in those cases was granted. Confirmation that dispensation has been granted in this case should be obtained before entering into the agreement.
85. The documents relating to the notice and to the dispensation application are in the council's website. 20 observations have been received in response to the notice, and have been responded to. None have raised issues that would suggest that this agreement should not be entered into if dispensation is given. The application itself is unopposed.

BACKGROUND DOCUMENTS

Background Documents	Held At	Contact
Utility contracts contract working folder	Energy Team, 3 rd Floor, hub 2, 160 Tooley Street, SE1 2QH	Chris Owen 020 7525 7728

APPENDICES

No	Title
None	

AUDIT TRAIL

Cabinet Member	Councillor Barry Hargrove, Cabinet Member for Transport, Environment and Recycling
Lead Officer	Deborah Collins, Strategic Director of Environment and Leisure
Report Author	Chris Owen, Energy Manager
Version	Final
Dated	4 July 2013
Key Decision?	Yes

CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER

Officer Title	Comments Sought	Comments Included
Head of Procurement	Yes	Yes
Director of Legal Services	Yes	Yes
Strategic Director of Finance and Corporate Services	Yes	Yes
Head of Specialist Housing Services	Yes	Yes
Contract Review Boards		
Departmental Contract Review Board	Yes	Yes
Corporate Contract Review Board	Yes	Yes
Cabinet Member	Yes	Yes
Date final report sent to Constitutional Team		4 July 2013