

Item No.:	Classification: Open	Date: July 28 2009	Meeting Name: Deputy Leader & Executive Member for Housing
Report title	Gateway 1 - Procurement Strategy Approval Supply of Gas to the Aylesbury Estate and Blakes Road (North Peckham) boiler house		
Ward(s) or groups affected	Faraday / Peckham / East Walworth		
From	Strategic Director of Environment & Housing		

RECOMMENDATIONS

1. That the Executive Member for Housing approves the procurement strategy outlined in this report for the supply of gas to the Aylesbury Estate and Blakes Road (North Peckham) boiler houses.
2. That the Deputy Leader and Executive Member for Housing approves the use of a Consortium contract with Buying Solutions to award the contracts for the supply of gas to the Aylesbury Estate and Blakes Road (North Peckham) boiler houses as follows:
 - i) With Corona Energy for the period 1 August 2009 to 31 September 2009, and
 - ii) With the new flexible framework contract provider for the period 1 October 2009 to 31 March 2011.
3. That the Deputy Leader and Executive Member for Housing approves the delegation of the contract awards to the Finance Director for the reasons set out in paragraph 30.

BACKGROUND

4. The estimated annual cost of the contracts is £1,791,000. The contracts will be awarded for a period of 20 months; the total value of the contracts is estimated at £2,985,000.
5. These contracts can be extended on a year by year basis up to the limit of their permitted duration under EU law. However, further approved procurement options for buying gas are likely to become available over the next year. It is therefore recommended that the contract be awarded for the minimum 20 month period, and that the Council's procurement options reviewed over this period.
6. This report is on the Forward Plan for a July 2009 decision.

Reason for this procurement

7. These contracts cover the supply of gas to the Aylesbury Estate and the Blakes Road (North Peckham) boiler houses which provide community heating supplies to dwellings. These two supplies have historically been let as a separate contract due to the high levels of gas consumed through each meter.

8. The current contract is with E.ON Energy and is due to expire on 31/07/09. There is no provision for extending the contract.

Market Considerations

9. The wholesale price of gas comprises more than 80% of the total cost of gas paid by customers. The remaining share is made up of charges fixed by the gas regulator (for operation of the gas distribution network), billing, administration and supplier profit. The UK wholesale gas market is highly volatile and prices are fixed by traders on a daily basis.
10. A further feature of the wholesale energy markets is that the majority of trades are speculative and are done on behalf of financial organisations who will not ultimately use the energy. Where suppliers have secured volumes of energy at below market rates they will speculatively trade these volumes rather than sell at this price to end customers. The result is that customers are offered the same average wholesale market price by all suppliers and therefore competition between suppliers only realises around 1 – 2 % difference in prices. The largest impact on the end gas price is the decision when to buy, and how much gas to buy at that time (i.e. to cover the total demand for a year or just a portion).
11. In the last few years, the wholesale gas market has seen rises and falls in excess of 100%, with each price movement taking place in less than a year. Gas prices fell over autumn and winter 2008 following the global economic downturn. However, current prices have not fallen to the historic low levels of 2007 when the current contract price was settled. The current average market price is 28% greater than when the previous contract price was settled on 10th July 2007.

Summary of the business case

12. This contract is a re-tender for an existing requirement for gas supplies to the Aylesbury and North Peckham estates.
13. The Council has historically let 'fixed price fixed term' (FPFT) contracts for energy supplies through a third party agent. For such contracts, suppliers offer a fixed unit price over the contract period – typically one or two years. As market prices are highly volatile, contract prices have to be settled on a single day and the tender process must be executed electronically. While the day selected for the tender can be selected according to market conditions, the decision still carries a significant risk of fixing a price for the whole contract volume on one day.
14. The previous contract was awarded using a third party electronic tendering process (provided by the "Utilities Exchange").
15. Suppliers offering FPFT contracts build in a high 'risk premium' to their price to cover their long term position on the fixed prices offered to the customer. In addition to this built in risk premium, there is no opportunity to benefit from any subsequent falls in the wholesale price.
16. The Council has been a leading participant in the London Energy Project managed by Capital Ambition 'Regional Improvement & Efficiency Partnership' (RIEP). This was established to review energy procurement across London authorities, and to identify and promote best practice in energy procurement.

17. A pan government energy project was launched in April 2007 to review energy procurement across the whole public sector (sponsored by the MoD). The project reviewed the energy procurement practices of the majority of large public sector buying groups (including OGC, NHS and all the local government buying consortia). The project has developed a set of compliance criteria against which public sector energy procurement strategies will be assessed as demonstrating best practice. Compliant strategies have then been promoted as “recommended” solutions.
18. The recommendation from both projects is that public sector authorities should adopt a “managed flexible” procurement strategy to respond to:-
- The fact that competitive tendering does not influence or determine the energy price offered (as described in paragraphs 9 & 10).
 - The short term high volatility in the wholesale energy price (as described in paragraphs 13).
19. A flexible contract removes the wholesale cost of energy from the competitive tender process. A competitive tender process is used to select the best supplier on the basis of their customer services, billing systems and mechanisms for purchasing on the wholesale energy market. The supplier is then instructed to purchase portions of energy from the wholesale market according to a pre-defined risk management strategy. Wholesale purchases can be made before and during the contract period thus spreading the risk of fixing the price for the whole contract demand on one day. Individual trades on the wholesale market are made in blocks of 10 MWh (mega Watt hours). A flexible contract can therefore only be operated via a consortium approach aggregating the demand of several local authorities.
20. Contracts offered by the three public sector buying consortia available to London Boroughs have been evaluated against the pan government criteria. Only two are currently recommended as best practice:-
- Buying Solutions – executive agency of the Office of Government Commerce (framework supplier is Corona Energy).
 - LASER part of Kent County Council commercial services (framework supplier is British Gas).
21. LASER offer a fully managed contract where:-
- LASER’s buying team instruct the framework supplier to purchase gas from the wholesale market according to market intelligence.
 - The supplier invoices LASER directly.
 - LASER undertakes basic checks for accuracy on the invoices and will only invoice clients when correct invoices are issued.
 - LASER then invoices the client with their service charge added.

The LASER charge is added as an increment to the unit cost of gas, for this contract their charge is set at 0.009 p/kWh. Based on the expected consumption through both supplies this would amount to an annual fee of £8,543.

22. The Buying Solutions contract only provides management of the wholesale purchasing:-
- Buying Solutions buying team instruct the framework supplier to purchase gas from the wholesale market according to market intelligence.
 - The supplier then directly invoices clients (who are responsible for monitoring the accuracy of their own invoices).
23. Buying Solutions charge a flat annual fee per supply meter of £240. As there are only two meters on this contract, the annual charge will be £480.
24. The Energy Team within Environment & Housing currently monitor the gas consumption for all the communally heated estates. Gas meter readings are taken by contractors on a weekly basis and are used to validate the current supplier's invoices. As the two highest consuming sites in the Council's portfolio, the current contract is monitored closely. It is therefore considered that the additional monitoring services provided through the LASER contract are not required for the two supplies on this contract.
25. For the reasons outlined above, it is recommended that the Council adopts flexible managed contracts for securing energy supplies. It is also recommended that the gas supplies for this contract are secured via the Buying Solutions framework contract.
26. The existing Buying Solutions framework contract (with Corona Gas) has been extended to September 2009. The new flexible framework contract has been advertised in the OJEU to start 1st October 2009 (to select a new framework gas supplier).
27. The Buying Solutions contract operates with two annual flexible purchasing rounds starting in April and October of each year. Each flexible purchasing round requires a six month lead in period to participate, but clients can join the framework contract at any time as Buying Solutions will secure a fixed price supply of gas from the wholesale market up until the start of the next flexible purchasing round. After the award of the new framework supplier in October 2009, the first flexible purchasing round will therefore start in April 2010.
28. Buying Solutions require clients to contract for a minimum of one complete flexible purchasing round (i.e. from April 2010 – March 2011). The recommended contract period will therefore be 20 months – from 1st August 09 to 31st March 2011. There may be a change in supplier from October 2009 depending on the outcome of the Buying Solutions tender process.

KEY ISSUES FOR CONSIDERATION

Procurement project plan

Activity	Planned date
Gateway 1: Procurement strategy for approval report (this report)	15/07/09
Completion of tender documentation	These tasks completed by Buying Solutions
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	
Gateway 2: Contract award for approval report	July 09
Contract starts	01/08/09

Identified risks and how they will be managed

29. 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 two energy procurement solutions being recommended as being best practice by central and regional government.
30. Buying Solutions will need to secure an initial fixed price of gas for the period up to April 2010 (the start of the new flexible contract). This price will be secured via the contracted supplier (Corona) from the wholesale market instructed by the Buying Solutions buying team (using market intelligence). Due to the volatility of the energy market and the need to make timely decisions (as set out in paragraph 13) to secure the most favourable energy prices for the Council, it is recommended that the award of this contract is delegated to the Finance Director. A notification requesting Urgent Implementation of the contract will be submitted.

Development of the tender documentation

31. Tender documentation has been completed by Buying Solutions.

Advertising the contract

32. Both the existing and future flexible framework contracts for gas supplies have been advertised in the OJEU by Buying Solutions.

Evaluations

33. The wholesale price of gas is excluded from the tender evaluation as this is purchased on an ongoing basis according to market conditions. Buying Solutions evaluate the flexible gas contract tenders according to customer service and facilities to enable the wholesale purchasing of gas.

Community Impact Statement

34. This contract covers gas supplies to central boiler systems which provide heating to the Aylesbury Estate and the remaining housing blocks served by the Blakes Road (North Peckham) boiler house. As such, the contract gas costs will ultimately affect the service charges to all tenants and leaseholders on the two estates.

35. The procurement route being recommended in this report is specifically designed to minimise the risks associated with the extremely volatile gas market, and therefore achieve the lowest gas prices for tenants and leaseholders.

Sustainability Considerations

36. This contract is concerned with securing natural gas supplies to heating systems. As such, there are no sustainable alternatives for this form of supply. The longer term plans for re-developing the Aylesbury Estate proposes adopting district heating with the additional use of combined heat and power (CHP, to generate heat and electricity at the same time) and the use of biomass fuels (e.g. wood chips or pellets). This will reduce CO₂ emissions, and is a more flexible energy supply option as natural gas CHP can be substituted with bio-fuel CHP when this becomes commercially viable.

Other Implications or Issues

37. There are no further specific implications or issues.

Financial Implications

38. Since the contract prices were last settled, there has been an increase in wholesale gas costs of 28%. At the time of setting the annual service charges to tenants it was forecast that there would be an increase of 90% in this contract's costs. This was based on the high wholesale gas prices before the collapse of market prices following the economic turndown. Based on this increase (and current consumption levels), the predicted annual costs for budget categories are shown in the table below. All costs incurred are recharged to tenants and leaseholders.

Table 1

Site	Predicted annual cost	Current annual cost	Annual increase
Aylesbury Estate	£1,364,687	£1,066,162	£298,525
Blakes Road boiler room	£426,317	£333,060	£93,257
Total	£1,791,004	£1,399,222	£391,782

Consultation

39. This contract covers the supply of gas to central boilers supplying housing estates. A Notice of Intention has therefore been served to leaseholders to comply with Section 20 of the Landlord and Tenant Act, informing them of the intention to tender for this contract. Leasehold Management will be applying to the Leasehold Valuation Tribunal for dispensation, due to the fact that a response to tenders is required within the day.

SUPPLEMENTARY ADVICE FROM OTHER OFFICERS

Strategic Director of Communities, Law & Governance

40. The Strategic Director (acting through the Contracts Section) notes the proposed procurement strategy set out in this report. The Council's Contract Standing Orders (CSO) permit the use of a consortium agreement, so long as approval is given via a Gateway 1 report which should identify the procedure and route for approvals for future orders/works being placed under the consortium agreement. Where such a situation applies, the requirements contained in CSOs for obtaining tenders or quotes shall not apply.
41. Given the potential value of the contracts, the manner in which they are procured will be subject to the application of the current EU Procurement Regulations. However, the report confirms that both of the Buying Solutions framework agreements have been advertised through the publication of OJEU contract notices, in line with the procedural requirements of the Regulations.
42. The Strategic Director further notes the proposal to delegate the award of the contracts to the Finance Director. This is permissible under CSOs and the reason for doing so is explained in paragraphs 13 and 30.

Corporate Procurement

44. With a total potential value of £2.98m, this procurement meets the criteria of a EU general protocol, requiring that all reasonable steps are taken to obtain at five tenders following a publicly advertised competitive tendering process. This report is seeking approval to use an existing consortium agreement for the reasons stated, and in accordance with CSOs, this negates the obligation to seek five tenders.
45. The report confirms that the proposed Buying Solutions agreement has been awarded in compliance with EU requirements.
46. As the Buying Solutions agreement will shortly be re-awarded, and because of the need to sign for a term of twenty months, this report is in fact seeking approval of the procurement strategy for two contracts.
47. It is noted that whilst the total potential term of the contracts is five years, it is not the Council's intention to automatically take up this option, hence the advised value for the twenty month term. The report author has advised that options will be reviewed at the appropriate time and either a gateway three or one report produced.

48. The evaluations will be undertaken by Buying Solutions.

49. It is noted, that due to the expedient need to accept quoted prices, approval is hereby sought to delegate the award decision to the Finance Director.

Finance Director (FIN0501 SO'B)

45. Current gas market indications are that there will be an average 28% increase compared with the previous contract prices. Based on current consumption levels, the predicted annual costs for both estates are shown in table 1. It should be emphasised that this report is recommending a set of fixed prices for the first year then a flexible buying method thereafter. All predicted costs are therefore estimates according to current market conditions. The actual billed costs in the second year will depend on future purchases of gas from the wholesale market.

BACKGROUND PAPERS

Background Papers	Held At	Contact
Schedule of gas sites	160 Tooley Street London SE1 2TZ	Bob Fiddik Energy Strategy Manager 0207 525 3804

AUDIT TRAIL

Lead Officer	Gill Davies, Strategic Director of Environment & Housing	
Report Author	Mary Morrissey, Head of Sustainable Services	
Version	Final	
Dated	July 2009	
Key Decision?	Yes	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / EXECUTIVE MEMBER		
Officer Title	Comments Sought	Comments included
Strategic Director of Communities, Law & Governance	Yes	Yes
Finance Director	Yes	Yes
Corporate Procurement	Yes	Yes
Executive Member	Yes	Yes
Date final report sent to Constitutional Officer		27 July 2009