

# Wiltshire Council

## Cabinet

24 September 2013

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Subject: **Supply of Energy, Electricity and Gas**

Cabinet member: **Cllr Stuart Wheeler - Hubs, Human Resources, Legal, Democratic Services, Governance, Heritage and Arts**

Key Decision: **No**

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### Executive Summary

#### Background

1. The council's current contractual arrangements through the Government Procurement Service (GPS) ends 31 March 2014 and six months notice is required i.e. by 30 September 2013, to avoid being committed to procuring from GPS from 1 April 2014.
2. GPS does not presently offer some of the services identified by the Council as required in the future. We therefore wish to change supplier.
3. The council procures energy to meet its own requirements, but also facilitates other partners such as fire services to buy off its contractual arrangement if they wish to opt-in to do so. This facility will be maintained in any new arrangement. In 2012/13 the council's spend was:

#### Electricity

Schools	£1,192,382
Non-Schools	£3,333,882
<b>Total</b>	<b>£4,526,265</b>

#### Gas

Schools	£1,142,913.13
Non-Schools	£1,050,789
<b>Total</b>	<b>£2,193,702.13</b>

4. Detailed Opportunity Assessments (OA), attached, were undertaken by the Council to establish the options and best value solution for our future electricity and gas needs. This included extensive engagement with and support from both private and public sector energy brokers (specialist energy buyers) to understand the supply market and methods used to buy energy. The energy supply market is complex and it is difficult to secure

any certainty about future prices and the relative value of those prices, which is often only clear in hindsight and where there has been a significant and sustained movement in prices, up or down.

### **Procurement Approach**

5. Options considered for the procurement approach or “route to market”, included:
  - 5.1 developing an in-house capability
  - 5.2 establishing an agreement to buy through another Local Authority’s buying team
  - 5.3 running a tender(s) to contract with both a broker and licensed energy supplier
  - 5.4 continuing the current route of using a pre-approved Public Buying Organisation (PBO) broker’s, such as Yorkshire Purchasing Organisation, Laser, West Mercia Energy and Eastern Shires Purchasing Organisation, accessing their framework for both broker services (the PBO services) and access to their licensed energy supplier contracts – an EU compliant option negating the need to tender.
6. These options were considered and in light of the evidence in relation to the appropriate best value pricing strategy, summarised below, and to meet the timeframe for its implementation, the PBO route is recommended.

### **Pricing Strategy**

6. Energy commodity prices are volatile, though that volatility has been reducing in recent years, and remain subject to a range of geo-political, seasonal and speculative influences. The price is made up from three main elements:
  - 6.1 the generation and sale of energy as a traded commodity, subject to volatility beyond the control of the council (between 55-70% of total price)
  - 6.2 the distribution of the energy to the local area (between 20-35% of total price), and
  - 6.3 supplying the energy within the local area to the meter/point of use (between 1-25% of total price)
7. This complex and heavily regulated market offers no meaningful scope for negotiated savings. The main opportunity for savings depends upon exploiting the volatility in the commodity price to try and beat the market average price; accompanied by risk to certainty of price/budget. As

volatility reduces the potential price risks and reward also reduce. Historic broker performance, particularly during the 2008/9 period and claims for potential savings are therefore to be treated with caution.

8. The commodity is traded on an open market, in the same way as stocks and shares or other commodities. The choice of pricing strategy is informed by the buyer's appetite to place budget certainty at risk in pursuit of lower prices, by exploiting that volatility and trading energy during the contract period creating variable pricing in year. Conversely budget certainty can create risk of paying too much as a price can be easily and quickly fixed on a single day, ignoring the opportunity created by the volatility. Private and public sector brokers were not able to provide reliable evidence that either a purchasing within period, or fixed approach would yield greater reward than our current "locked" strategy, which reflects the best of both by a period of trading in the run up to the agreed pricing date to smooth the volatility, before securing a fixed price for the required period. Interestingly PBO performance benchmarked, however questionable the accuracy of benchmarking may be, favourably with private sector brokers. Consequently securing an appropriate balance of risk/reward for the council favours the continuance of the current "locked" price strategy.
9. Assessing the input from the public and private brokers consulted during the development of the OA, established that PBO offered equivalent pricing options and services, and potential for best value to private sector brokers. Furthermore they support faster and cheaper routes to contract which enable the timely implementation of the recommended pricing strategy. Therefore a continuance of the use of a PBO other than GPS, offers the most suitable route to market.

### **Service Offer**

10. The private sector brokers and PBO were assessed to establish whether they offered the services required by the council to improve their management of our requirements and also the fees proposed. Both private sector brokers and most PBO do provide the services, but GPS do not and so will not be our future supplier.

### **Savings**

11. A target saving based upon consumption reduction of 5% has been set for next year for non-schools usage. At current prices and based upon the current estate and operating hours in cash terms this equates to a budget reduction of £162,450 for electricity and £45,540 for gas pa.
12. Invoices typically have an error rate of 10%, many of which are routinely

identified and corrected, however by securing an invoice checking service further savings of 1-3% of spend are anticipated, between £45,000 and £135,000 pa for electricity and £21,900 and £64,700 for gas.

13. By adopting the recommended strategy it is anticipated that we will continue to beat the market average price by around 10% for commodity costs. This is in line with the evidence of market best practice and equates to maintaining cost avoidance savings on total 2012/13 spend of £270,000 pa for electricity and £96,500 for gas. This does not offer cashable savings however continues to provide best value for the council portfolio of requirements.
14. The cumulative benefits anticipated from implementing these proposals are 6-8% of energy spend.

### **Proposals**

15. Cabinet resolve to procure its energy requirements for council operated buildings and some schools, using a locked pricing strategy, through a PBO pre-approved framework for a maximum of a three year period from 1 April 2014 through to 31 March 2017.
16. Cabinet resolve that delegated authority is given to the Service Director, Business Services, in consultation with the Cabinet Member for Business Services, to have executed all necessary documents required for the Council to join an appropriate energy supply framework.
17. Cabinet acknowledge the complexity of the energy market and resolve that in advance of the end of the new agreement, the council seek independent professional advice to develop an assessment of our energy requirements and associated options and recommendation for future procurement.

### **Reason for Proposal**

18. To secure the council's energy supplies from 1 April 2014 and deliver best value for the council and any partners that opt-in.

**Jacqui White and Michael Hudson**  
**Service Directors, Business Services and Finance**

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### Purpose of Report

1. This report seeks to explain the council's current energy supply arrangements which end 31 March 2014, the work undertaken to establish the options and identify the best value procurement solution. The desired outcome is Cabinet resolution to support the award of contracts to secure supply for a period of up to three years until 31 March 2017.

### Background

2. The council's current arrangements for energy are provided via the Government Procurement Service' (GPS) pre-approved framework contracts with EDF and British Gas for electricity and Corona for Gas, which will automatically renew after contract end 31<sup>st</sup> March 2014 unless other arrangements are made. In order to exit the contracts notice needs to be served six months ahead of the end date i.e. 30 September 2013. Data on recent spend is shown in the tables below. The variability is due to changes in price, consumption and from estate changes, for example taking on DC Leisure in 2011-12:

#### Electricity

	<b>FY 2009-10</b>	<b>FY 2010-11</b>	<b>FY 2011-12</b>	<b>FY 2012-13</b>
Schools	£2,460,613	£1,909,916	£1,555,814	£1,192,382
Non schools	£3,575,656	£2,983,773	£3,668,210	£3,333,882
Total	£6,036,270	£4,893,690	£5,224,024	£4,526,265

## Gas

	<b>FY 2011-12</b>	<b>FY 2012-13</b>
Schools	£741,523.25	£1,142,913.13
Non-Schools	£797,515	£1,050,789
Total	£1,539,038.25	£2,193,702.13

3. The council has historically made its corporate energy contracts available to schools and other partner organisations such as the Fire service that want to opt-in and wishes to continue to do so.
4. The council wish to secure additional services as part of any future procurement that support its aims of delivering best value energy solutions, some of which it does not presently receive from GPS. As a result GPS will not be used to secure energy from 1 April 2014.
5. The council operates both an energy and environmental policy, key aspects of which require it to:
  - 5.1 deliver responsible energy management
  - 5.2 continually improve energy performance as part of its wider environmental and property management strategy
  - 5.2 reduce energy consumption across the estate
  - 5.4 reduce energy consumption and carbon emissions associated with council services
  - 5.5 buy energy in a cost effective manner

### **Main Considerations for the Council**

6. Under the current framework contract arrangements we have placed call-off contracts through GPS for a range of energy supplies. Even if the GPS framework contracts end before 31 March 2014 our call-off contracts will continue until that date:

## Electricity

<b>Type of supply</b>	<b>Supplier</b>	<b>GPS Framework expiry dates</b>
Half Hourly	EDF	15 <sup>th</sup> August 2015
Unmetered Street lighting	EDF	15 <sup>th</sup> August 2015
Non Half Hourly	British Gas	30 <sup>th</sup> September 2013

## Gas

Supplier	GPS Framework expiry dates
Corona	31 <sup>st</sup> March 2016

7. Energy pricing is based on the generation and sale of energy as a traded commodity subject to volatility beyond the control of the council (typically 55-70% of total price), the distribution of the energy to the grid supply point (typically 20-35% of total price) and the subsequent supply to the meter/point of use (typically 1-25% of total price). As an example of the volatility risk, in 2008 the energy market experienced an increase of 100% in electricity prices.
8. Since almost all the costs other than the commodity price itself are heavily regulated, managing the commodity cost is key. It can only be influenced by the choice of pricing strategy which is discussed in more detail under "Options considered".
9. Our research identified that as the market was largely similar in nature and approach, the key issues influencing our recommendation were:
  - 9.1 Pricing strategy – a balance between budget certainty and the opportunity for beating the market average commodity price
  - 9.2 Route to market – the best method to award the right contract, and
  - 9.3 Service offer – must provide the required services
10. In relation to 9.1 the market price is volatile and savings cannot be assured through any strategy. Further, it is not possible to subsequently benchmark performance between organisations to assure that you could have done better since the size of the orders, timing and strategies each of the brokers use are variable. Each broker can only benchmark their own performance against a market average price index that they select to test their performance. Selection of the appropriate pricing strategy is therefore critical to our prospects of securing best value and mitigating risk. It is only possible to establish that one has over or underpaid where a significant, protracted and unexpected trend in prices takes place that over or underpaying is obvious. This is mitigated by buying our energy for shorter term periods off the supply contract, historically typically a year, however in a rising market a two year period might be preferable.
11. Further to 9.2 the Public Buying Organisations (PBO) such as GPS offer a timely and lean route to market, using pre-approved frameworks set up to support public bodies to buy effectively. Benchmarking suggests that GPS price performance is in line with private and public sector peers; in fact confidence in potential performance was similar for all organisations.

We have a neutral stance on private or public sector broker performance, though critically to secure the recommended pricing strategy a PBO can deliver for 1 October 2013.

12. Reference 9.3 the current GPS service does not presently provide the level of customer engagement and review that we would wish to receive, or specific services we consider offer an opportunity to ensure best value such as invoice checking, which could save 1-3% of spend or between £45,000 and £135,000 pa for electricity and £21,900 and £64,700 for gas. We are satisfied with their price performance and trading capability, but do not consider they can meet our future service needs.
13. The council does not have the expertise to deliver an energy buying service in-house.
14. The council does not have the technical expertise to tender for its energy requirements itself and is reliant upon its selected broker to do so. As the engagement with brokers evidenced the complexity of the market, we plan to engage independent professional advice to inform our future procurement options to align with the end of the recommended contract herein.
15. Engagement with other Local Authorities (LAs) has established that some are not open to us joining their current arrangements, and that where we might, their strategies, capacity and concerns about working with other LAs such as Wiltshire do not match our requirements. Further there is no evidence that their capability and potential to select the best value procurements is likely to be better than the buying team of a PBO.

### **Safeguarding Implications**

16. This requirement has been reviewed with the Service Director responsible for Safeguarding and has been assessed as having no Safeguarding implications or impact.

### **Public Health Implications**

17. This requirement has been assessed by Public Health and determined to have no implications or impact.

### **Environmental and climate change considerations**

18. **Will the proposal result in energy consumption associated with the service area increasing, decreasing or remaining roughly at current levels?**



## Electricity and gas

This procurement relates to the supply of electricity and gas and so this proposal and award of any contract will not directly influence consumption, except that the requirement to provide performance monitoring information to the council will support us to identify usage anomalies and review where consumption can be influenced.

19. **What measures have been introduced, or are planned to be introduced, to reduce the carbon emissions associated with the proposal?**

## Electricity

As this proposal relates purely to the supply of the commodity, issues such as estates management and street lighting management are not relevant. It is possible to reduce the related carbon emissions by buying green electricity and we will seek to procure green electricity wherever the balance of cost and benefit supports it. Where green electricity meets the government definition, associated emissions can be deducted from our annual Greenhouse Gas footprint report.

## Gas

There is no scope to affect carbon emissions through the commodity purchase of gas. Unlike electricity there is no option to procure green gas.

As we are obliged to buy carbon allowances under the Carbon Reduction Commitment (CRC) Energy Efficiency Scheme for the energy we use, better billing and invoice management will reduce those costs, around 8% of our CRC spend (approx £500,000pa), by around 10%, or 0.8% of total CRC spend equating to £4000 per annum.

20. **From the perspective of day to day environmental management, what risks associated with the proposal have been identified and how are they going to be mitigated?**

## Electricity and gas

To best manage the requirement to buy carbon allowances, the selected supplier must offer a streamlined data-rich service with tightly controlled management e.g. accurate and regular billing, and swift query management.

21. **If the service or contract is planned to last longer than 20 years, how have issues related to the unavoidable consequences of climate change been integrated and**

mitigated? For example, increases in the mean summer temperature and increased vulnerability to adverse weather events like heavy snow or floods.

### Electricity and Gas

Not applicable. The proposal is for a contract that may be used for up to three years.

### **Equalities Impact of the Proposal**

22. There are no equalities impacts from the procurement of energy.

### **Risk Assessment**

23. The procurement of energy is based on a complex and heavily regulated market. That said, there are well established private sector and PBO with extensive experience of the market with buying teams of significant size and capability offering a service that minimises the risks of attempting to buy it ourselves. There is a general market view that prices are trending upwards for the next few years, however there will be volatility during that period which is mitigated through the selected pricing strategy.

### **Risks that may arise if the proposed decision and related work is not taken**

23.1 We will be tied to GPS for a further year and lose the opportunity to secure improved service quality

### **Risks that may arise if the proposed decision is taken and actions that will be taken to manage these risks**

<b>Risk</b>	<b>Action to mitigate the risk</b>
23.2. Price volatility increases	The pricing strategy aims to balance this risk with the potential for reward. The council will review performance regularly to secure forecasting information to inform decisions on pricing periods
23.3 Prices move consistently higher/lower	The council will review performance regularly to secure forecasting information to inform decisions on an appropriate pricing period i.e. 12/24/36 months ahead

## Financial Implications

24. The non-school budget for 2013-14, determined in November 2012 from the previous year's budget and an inflationary element as appropriate for the sector is:

### Electricity

<u>Electricity (excluding street lighting):-</u>	£1,952,600
<u>Street lighting:-</u>	<u>£1,297,000</u>
Total	<u>£3,249,600</u>

Gas £910,800

25. There is budget risk inherent in buying a commodity from a traded market that can be eliminated by securing a fixed price. As described in the options at 31.1 through 31.3, the simplest route to a fixed price and budget certainty limits the application of brokers trading expertise. A full trading strategy does not offer any budget certainty and delivers variable pricing in period. The recommended strategy, a continuation of the current approach, provides the benefits of both and maintains current non-cashable price performance potential at beating the market average commodity cost by around 10%, a £270,000 pa benefit for electricity and £96,500 for gas.
26. Longer term, energy prices are expected to increase and so efforts to reduce usage, and thus mitigate the impact of rising costs, will become more important. It is not possible to accurately predict the future budget implications of procuring in this market but it is possible to better control the amount of energy that is used. A target reduction of 5% consumption has been set for next year for non-schools usage. At current prices and based upon the current estate and operating hours this would equate to a budget reduction of £162,450 for electricity and £45,540 for gas. However cutting the energy demand of the council will not only have an immediate impact on the bills but will resonate long term and will increase in value over future years. Getting a better price for energy now through procurement will have an impact now but will not guarantee a better price in the future. Whereas reducing energy demand now stays as a saving for years to come and even increases in value in a rising market.
27. See table below for an example of how the 5% demand reduction saving would increase in value over 5 years based on an assumed energy price rise of 5% per year. Further energy demand reduction each year would compound the end saving.

2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
£4,159,800.0 0	£4,367,790.0 0	£4,586,179.5 0	£4,815,488.4 8	£5,056,262.9 0	£5,309,076.0 4
£207,990.00	£218,389.50	£229,308.98	£240,774.42	£252,813.14	£265,453.80

28. Examples of demand reduction work that are already underway or planned include the ongoing 'Invest to Save' programme of energy saving projects; the roll out of the ISO5001 Energy Management System to extend energy conservation work into all key influencing services across the council; and the introduction of a 'Building Controls' programme of works to cut out energy waste in the corporate estate.
29. As prices have not yet been set for the contract period, this budgetary saving should be allocated as an earmarked reserve to mitigate unexpected price changes and ensure the budget variations are dealt with effectively from one year to the next. The potential savings are between 6-8% of total energy spend based on current prices and usage.

### Legal Implications

30. There are no specific legal implications arising as a result of this procurement. A European Union and UK compliant contract will be awarded.

### Options Considered

#### Pricing strategy

31. There are several methods (pricing strategies) for buying energy commodities each with different risk and reward considerations.

##### 31.1 Fixed - Buy all our requirements on a single day

This assumes that a particular day is the best for buying all our energy requirements. It can be a very high risk/reward option, but implies limited professional judgement being applied to mitigate market volatility and manage the risk to the council. Given the volume of energy traded, the council's requirements are not likely to attract particular price benefits alone, the aggregation of energy for trades through broker volume is most likely to secure value. This strategy is not recommended.

### 31.2 Continuous trading during the contract period

This does not provide price or budget certainty. It endeavours to maximise value through applying trading strategies to buy the commodity on the futures market for specified periods. This smoothes out the peaks and troughs caused by volatility, but creates price and budget uncertainty as the price paid for energy also changes during the contract period. The performance benefits of this strategy did not evidence increased value over our current strategy, but does introduce new risks and so this strategy is not recommended.

### 31.3 A period of trading followed by a fixed price for an agreed period

This is our current option and allows the council to benefit from a broker applying trading strategies to the commodity price for a 6 month period leading up to 1 April 2014, whereupon the price will be fixed for the period. This provides price and budget certainty for the council and partners while smoothing volatility. This strategy is recommended.

## Route to market

32. Four routes to market were considered:

### 32.1 Pre approved framework

There are a range of pre-approved frameworks available that have been awarded in an OJEU compliant manner, by PBO. The main PBO are ESPO, YPO, GPS, Laser, WME and NEPO. These offer an economical route to contract, a similar fee level and performance to private sector brokers, have differing structures but equivalent overall fees and many offer the required services. They can also meet the required timeframe to implement the recommended pricing strategy. This route and award to an appropriate PBO is recommended.

### 32.2 Buying through another Local Authority who procure energy themselves

The evidence suggests they would not be able to benchmark more favourably against any other solution and they acknowledge difficulties in collaborating with other Local Authorities in relation to timing and pricing strategies. We would also be asserting that their

team possess capacity, knowledge, tools and skills that outweigh those of the more established PBO, which the limited information provided does not support. There is also no guarantee that we could agree the service terms and price in time to meet the required date to implement the recommended pricing strategy. This route is not recommended.

### 32.3 Tendering for a broker and licensed energy supplier (private sector)

There is an established market of private sector brokers who have largely private sector clients. They operate the same range of services as the PBO, same fee levels, deliver similar levels of commodity price and so do not provide a proven value advantage against using the pre-approved PBO frameworks. In our discussions the private sector brokers were keen to identify that some of their peers operated opaque arrangements with suppliers that enabled them to pass on only some of the benefits from their trading strategies and that great care needed to be taken to ensure that we had full visibility of the means by which the brokers earned fees. Bristol City Council acknowledged this risk in their assessment as a reason to discount the option. It should be noted that private sector energy brokers are largely unregulated. This route; cannot be implemented in time to deliver the recommended pricing strategy; and benchmarking does not evidence better value or service than using a Pre-approved framework, it is not recommended.

### 32.4 Establishing our own energy buying team

This option conservatively requires us to employ two FTE specialist energy buyers and at least one FTE for invoice checking. The council would need to establish its own contracts with energy suppliers, which it cannot do in time to implement the recommended pricing strategy and procure trading software and tools to support the buyers to perform adequately. We also could not recruit in time. Established market services provide a more likely route to the lowest acceptable risk and most likely value opportunities. This option is not recommended.

## Service Offer

33. The current GPS service does not meet the requirements of the council. Contract reviews are not frequent enough and added value services, particularly around invoice checking are not available. The specification will ensure that additional services to support best value are included.

## **Conclusions**

34. The council and its partners are best served by procuring energy supplies from 1 April 2014 through entering into a contract with a PBO by 1 October 2013, implementing a locked pricing strategy and specifying further service levels in support of best value.

**Jacqui White and Michael Hudson**  
**Service Directors, Business Services and Finance**

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Report Author:

Greg Lewis, Corporate Procurement Unit, Category Manager (Place), 01225  
713395

Date of report: 09 August 2013

## **Background Papers**

None

## **Appendices**

1. Electricity Opportunity Assessment (Part 2)
  2. Gas Opportunity Assessment (Part 2)
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