

Wiltshire Council

Cabinet Capital Assets Committee

19 January 2016

Subject: Gas and Electricity supply contract post 2017

Cabinet member: Richard Tonge - Finance and Procurement

Key Decision: Yes

Executive Summary

The council is commencing the process for procuring the replacement electricity and gas contract to take effect from 1st April 2017. Total spend through this contract is approximately £7m per annum and the key procurement objectives are maintaining good quality of service and minimising costs.

A new arrangement must be in place by 30th September 2016 if an alternative provider were to be preferred to the current provider. This allows the council to begin the lengthy process of moving supplies and the new provider can start buying electricity and gas on the futures market thus reducing the risk of higher costs if the market rises and maximising the opportunity for lower prices.

An outline business case recommending the use of a public sector framework has already been agreed by Procurement Board.

The proposals are made to address existing risks and provide optimum value for money from April 2017 when the existing electricity and gas contract ends.

Proposal(s)

There are four proposals in this report. These are:

1. That the council takes advantage of flexible in-period purchasing with a risk cap. This will provide an opportunity for greater savings to be achieved, by placing a limited sum at risk.
2. That the council enters into a longer contract after 2017 and takes advantage of current market conditions as well as an extended purchasing window. A five year contract length is recommended.
3. That the council stay with the current provider, West Mercia Energy.
4. An appropriate contractual arrangement is put in place with schools wishing to access the contract and the council recovers the ongoing cost of administration.

Reason for Proposal

The proposals are made to address existing risks and provide optimum value for money from April 2017 when the existing electricity and gas contract ends.

Barry Pirie**Associate Director, People and Business**

19 January 2016

Subject: Gas and Electricity supply contract post 2017

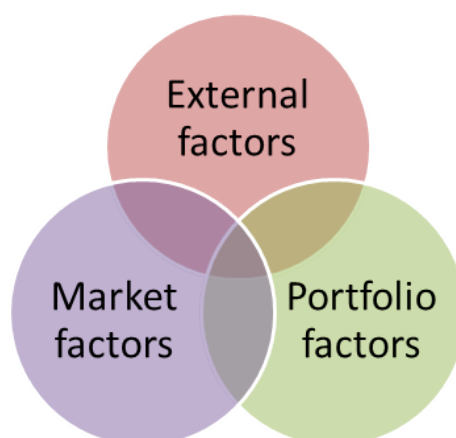
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Key Decision: Yes

1. Purpose of Report

This report sets out the recommended energy purchasing strategy for the council from 2017 – 2022 in order to support achievement of value for money and continued resource efficiency.

This report relates to procurement within the relatively complex electricity and gas marketplace. The main factors influencing cost to the authority are illustrated below with a brief summary of these factors and what can be done to mitigate them. This procurement is aimed at addressing the Market Factors element.



Main cost drivers to energy costs

The unit price for electricity and gas comprises the commodity price and standing charges, with each representing about 50% of the overall price. In recent years the commodity price has fallen while standing charges have increased. Reductions in crude oil price only affect the commodity element and falling oil prices can be offset by cost increases elsewhere, resulting in little overall change. Supply and demand and many other factors contribute to the unit price and prices have been seen to move by up to +/-20% between years.

	Sources of cost	Risk	Mitigation
External	Weather/climate, legislation	Heating and cooling costs, additional charges	Space temperature policy, building design and control
Market	Suppliers respond to macro-economic issues, trading cost and risk	Infrastructure investment, risk cost, environmental taxes and oil price contribute to cost increases	Procurement strategy, bulk buying
Portfolio	Energy intensive buildings (leisure), operating hours, energy efficiency of buildings	Some facilities are intrinsically higher cost (swimming pools), longer hours and poor efficiency increases costs	Optimise and invest in equipment, minimise operating hours and promote responsible use of energy

Climatic conditions also heavily influence annual spend on energy. Cold winters increase natural gas costs through additional heating. Warm summers increase electricity costs through additional comfort cooling. Conditions cannot be known in advance and the budget setting cannot reflect this with certainty. Due to the limited history available the electricity and gas budget is based on 2013-14 spend only and is not currently adjusted each year. Adverse conditions during the year or changes in prices may therefore create an overspend which must be compensated for elsewhere within the overall budgets of the relevant service areas. If unit price and weather conditions both move in the same direction the change relative to previous years (and underspend or overspend in a given year) would be magnified. This paper recommends actions that are expected to reduce the risk of overspend.

2. Relevance to the Council's Business Plan

The recommended energy purchasing strategy will ensure the council is efficient and provides good value for money for Wiltshire residents.

3. Main Considerations for the Council

The council is commencing the process for procuring the replacement electricity and gas contract to take effect from 1st April 2017. Total spend through this contract is approximately £7m per annum and the key procurement objectives are maintaining good quality of service and minimising costs.

A new arrangement must be in place by 30th September 2016. This allows the lengthy process of moving supplies to begin a new contract and the new provider can start buying electricity and gas on the futures market thus reducing the risk of higher costs if the market rises and maximising the opportunity for lower prices.

An outline business case recommending the use of a public sector framework has already been agreed by Procurement Board. Therefore this paper makes recommendations in relation to:-

- The purchasing strategy

- The duration of the contract awarded
- The most appropriate public sector framework
- Schools access to the contract

The purchasing strategy

The current purchasing strategy employed by the council is a 'purchase in advance' model whereby energy is purchased flexibly through active trading by the provider prior to the contract start date. At the start date a price per unit of energy for electricity and gas is fixed for the year. By comparison, the 'purchasing in contract' model is identical, but only locks the price for four months at a time, and allows the trading activity to continue afterwards. This proposal is expected to reduce the risk of incurring avoidable costs, but is not expected to achieve cashable savings.

The benefits of the current approach include:

- simplicity, as prices do not change within the year;
- flexible purchasing up until the start of the year, which allows the provider to take advantage of the market up to the lock in point, trading flexibly to get the best overall deal.

The disadvantages of this approach include:

- any market opportunities occurring after the lock in point cannot be realised e.g. if the overall market prices fall within contract period or real-time opportunities arise with short term fluctuations in the market.

The council's current provider can provide both strategies and has confirmed that in the most recent contract year the authority sustained higher costs than was necessary because the preferred strategy prevented the provider from adapting to changing market conditions within the contract period. This arose because the current strategy meant some quantities of energy had to be bought at the prices that were current at the start of the year, despite all parties being aware the market was still falling and a better price would be available later. The proposal is therefore to learn from this and change the council's strategy to provide further opportunities within each of the contract years to adjust according to market conditions and take advantage if and where possible. This would not be detrimental if the market were expected to rise however, as the current competent provider would simply purchase a higher proportion of the council's energy requirement sooner in anticipation of prices rising, reducing the council's risk.

The proposal represents the best overall balance of risk and budget certainty and is neither overly risk averse or overly risky. In current times of pressure on revenue budgets and an uncertain world it is recommended that the more flexible stance be adopted with a cap on the risk the council will take to improve budget certainty.

The absolute risk is difficult to quantify as risk appears in different forms. In absolute terms the authority will accept the possibility for up to 10% additional cost each year, with the evidence-backed expectation that most or all of this will be returned unspent in that year. The provider has shown an excellent track

record of achieving avoided cost through active trading, in some cases realising up to 14% avoided costs within a year, in addition to the return of the 10% additional sum at risk.

Essentially the proposal can be considered as a similar risk to when choosing to increase the voluntary excess on insurance in order to reduce the premium. There is a risk involved, but in most cases this results in a net reduction in cost over time. This approach has recently been adopted by the council for insurance. On balance this was deemed to represent a more cost effective balancing of risk and reward. This proposal is consistent with that strategy. Currently WME purchases energy in advance before the contract period starts. The change to purchasing flexibly within period with a risk cap would enable the council to benefit from cost avoidance within year. Evidence from another council suggests avoided costs of 8% for gas and 6% for electricity have been realised because of the ability to trade more flexibly within period. The 10% risked value has been returned in each of the last five years.

Recommendation:

That the council takes advantage of flexible in-period purchasing with a risk cap. This will provide an opportunity for greater savings to be achieved, by placing a limited sum at risk.

The duration of the contract awarded

As energy is purchased on a futures market there can be a benefit to a longer contract period which allows for greater forward purchasing and selling opportunities out to the end of the contract. It can also allow for better price certainty forecasting.

Shorter contracts do not offer the same benefits, but they do allow customers to take advantage of other providers when the contract ends, or to leave an unfavourable contract after a shorter amount of time.

The council is currently in a three year contract (2014-2017) having been in a rolling one year contract for eleven years prior to that. The decision to take up a three year contract has been beneficial and has provided price and service certainty until 2017.

However, as this contract was a two year with one year extension this has meant procurement activities will have taken place in four of the five years up to 2017. These activities have a cost and resource implication which could have been avoided had the council had a longer contract in place.

The current market conditions are very favourable so it is a good time to purchase as far ahead as is possible. Giving the provider the maximum potential to exploit the market conditions will deliver the best value for money. Increasing the contract length from three years to five years is expected to increase the potential for delivering savings. In the energy futures market the furthest ahead you can purchase is five years and there is no clear advantage from a contract longer than this.

Recommendation:

That the council enters into a longer contract after 2017 and takes advantage of current market conditions as well as an extended purchasing window. A five year contract length is recommended.

The most appropriate public sector framework

The council is currently contracted with West Mercia Energy (WME). This is a public sector framework, meaning that WME has tendered the requirement and awarded contracts to a successful bidder, or bidders. The advantage of this to other public sector organisations is that they are able to make use of the framework without a lengthy tendering process. The council has the option to choose another pre-procured framework or remain with the current provider.

Unlike purchasing some other commodities the energy price cannot be guaranteed pre-contract over the contract period. For this reason price is less of a factor in selection. Therefore the authority must select the framework that is seen to deliver the best overall quality of service and highest probability of delivering a very competitive price.

The current provider has delivered exceptional customer service and reliability over the existing contract period. A review of the service provided against the service requirements indicates there is very limited scope for another provider to improve upon the current level of service. Changing providers is therefore not expected to deliver improvements in service to offset the resource cost of transferring supplies.

An exercise carried out as part of the procurement activity to take up the contract extension option showed savings on both energy costs and added value services. This was in the region of £300,000 over the contract period. Of this 80% arose through a comparison of current unit rates against those quoted by a competitor for the same period. The remaining 20% arose through action on the part of the provider that directly avoided costs through negotiation with suppliers or similar activity. There is no evidence that there is significant further scope to improve on the price given that such savings were already made by switching from one public sector framework to another. Similarly, it is apparent that high quality service directly delivers cost savings.

Moving to a new provider would not guarantee any financial benefit and represents a risk of a reduction in quality of service relative to the current very high standard. This was assessed in detail in the Opportunity Assessment (2013) and the Outline Business Case (2015). There is also the cost to changing providers that was estimated above and it is considered unlikely this will be offset given the limited scope for improvement and associated potential for avoided costs.

Recommendation:

That the council stay with the current provider, West Mercia Energy.

Schools access to the contract

There is currently no formal contract or agreement specifically covering the provision of electricity and gas to schools. One consequence of this informal arrangement is that schools can opt in and out at any time, which can increase the administration burden to the authority. A further consideration is the trend of schools becoming academies over time. As academies are separate legal entities this will require schools to leave the contract because the contract is not currently open to other organisations. Electricity and gas may be purchased years in advance to achieve attractive prices, but is not paid for by schools until it is received by them. School clients are currently under no contractual obligation to receive and pay for this energy and may leave voluntarily at any time. Furthermore, a large number of schools may become academies and therefore leave the contract for that reason before receiving this energy. Introducing an appropriate contractual arrangement with all schools that wish to access the contract is a simple and transparent way to remove these risks. For this reason it is recommended that the council continue to make the energy contract available to schools from 2017, but that an appropriate contractual arrangement is put in place with schools.

Currently schools have the option to access and take advantage of the rates available via the council energy contract and about 85% of schools have opted to do this. Those schools that do not opt into the contract must source their own energy contracts independently. Individual schools can be expected to receive a less attractive unit rate because risk is not spread across the wider council portfolio and therefore accessing the authority contract can typically be expected to deliver best value for money for schools.

School inclusion in the contract has an impact on council resources as part of the overall contract management and administration. These costs are currently borne by Business Services and no administration fee is charged to schools. Experience over a number of years indicates the resource impact varies between 0.3 FTE and 0.5 FTE. The total resource cost to the authority is assessed to be approximately £ 18,000 per annum. Total annual school spend via the contract is approximately £ 1.63m and a fee of 1.10% would cover this resource cost. On average this would increase the annual cost to a primary school by about £86.

It is recommended that the ongoing cost of facilitating schools inclusion in the contract is covered by a small administrative charge calculated to recover costs only. The framework for setting this charge and the services provided will be set out in the appropriate contract documents and schools would be required to sign this in order to continue to access the council contract.

Recommendation:

An appropriate contractual arrangement is put in place with schools wishing to access the contract and the council recovers the ongoing cost of administration.

4. Background

Wiltshire Council developed an extensive Opportunity Assessment (OA) in late 2012 and early 2013 which proposed the use of a public sector, pre tendered

framework for the purchase, supply and billing of gas and electricity. For the ten years prior to that the council had used rolling annual contracts with the now Crown Commercial Service (CCS) and its previous iterations. The CCS contracts were of a “let and forget” type which offered no contract management, or additional services and were very onerous to the council in terms of the contract management that was placed on council staff and the limited customer service on offer. The proposal in the 2013 OA to continue with the use of a pre tendered framework, albeit one chosen in a “mini competition” exercise, resulted in the award of a contract to West Mercia Energy (WME).

Competitive prices have been secured from this contract as well as excellent contract management on the part of WME. The two year contract started on 1st April 2014 and the one year extension to 31st March 2017 was recently endorsed by the Corporate Procurement Board. The contract will thus terminate on 31st March 2017 and a replacement contract must be in place six months prior to that date at the latest to enable the provider to start buying the council’s energy requirements for the contract start date on 1st April 2017.

5. Safeguarding Implications

There are no safeguarding implications.

6. Public Health Implications

There are no public health implications.

7. Corporate Procurement Implications

The decision to use a public sector framework was agreed by the Procurement Board on 8th September 2015 and will comply with all procurement regulations.

The recommendations in this document have been developed in consultation with Corporate Procurement.

If the main proposal to contract again with West Mercia Energy for a five year period is agreed, the procurement implication is minimal. There will be no lengthy tender or other sourcing exercise to award a contract. This provider is a Public Sector Buying Organisation (PBO) who procure suppliers through an OJEU compliant tendering exercise. The authority is therefore able to award to the PBO without the need to undertake the procurement activities that would otherwise be required. The energy suppliers are procured using framework contracts but there is not a choice of multiple suppliers for each of the two services (electricity and gas). As such there is no requirement to undertake a competitive process between candidates. WME specialises in energy supply provision and, unlike some other PBOs, it does not engage in other market areas.

For the reasons outlined above and in the OBC the authority is best served through continuing with the current provider. Towards the end of the proposed contract with WME (1st April 2017 - 31st March 2022) a detailed review will be conducted and a new Opportunities Assessment will be produced. In order to meet the timetable for changing providers in this marketplace it is expected that

the review process will need to begin no later than early 2020, less than three years into the contract. This will leave about 20 months to complete the full review process and the relevant procurement process so as to appoint a replacement with six months remaining before the contract end date. This is the amount of time necessary to prepare for the complex and resource-intensive process of transferring of energy supplies to a new provider.

8. Equalities Impact of the Proposal

There are no equalities impacts for this proposal.

9. Environmental and Climate Change Considerations

The proposed recommendations are made with consideration to the council's environmental and climate change commitments and in line with the council's energy policy and eco strategy. The proposal will not result in any impact on energy consumption. There are no associated carbon emissions. There is no impact on day to day environmental management and the contract is not planned to last more than 20 years.

10. Risk Assessment

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

Risk	Impact	Likelihood	Score	Mitigating Action
The council could be charged more for energy than is necessary if contract rates are not secured following the recommendations outlined above.	1 or 2	1	No more than 2	Timely approval of the proposal to treat again with WME.
The council could be subject to volatile price changes.	1 or 2	1	No more than 2	There is little the council can do to mitigate against price increases as these are dependent on geopolitical factors.
The council may miss an opportunity for securing the lowest possible prices	1 or 2	1	No more than 2	Timely approval of the proposal to treat again with WME will mitigate against this.
The council would incur unnecessary costs (see OBC) to change to a new supplier	1	2	2	Timely approval of the proposal to treat again with WME will mitigate against this.
Schools may miss out on potential benefit of a pre-procured and good value contract	1	1	1	Early communication with schools outlining the council's proposals on any contractual arrangement. Clear timescales for schools to respond.
Business Services will continue to deliver a service without recouping the cost of that service	1	1	1	Business Services consider the existing cost of providing the service and the fairest way of recouping that cost. Should schools pay based on the number of

				meters or floor plate of the school, for example? Or should there be a flat fee for all schools.
Business Services continues to be in a volatile position with schools if formal agreements for the use of the contract are not in place. Schools are currently unclear over their commitment to the contract and their responsibilities having opted in.	1	1	1	Any new arrangement is made clear to schools through various formats with a clear timescale by which they must respond indicating their intention.

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

Risk	Impact	Likelihood	Score	Mitigating Action
Deterioration of the service over the 5 year contract life.	2	1	No more than 2	Strong and meaningful KPIs and SLA's built into the contract from outset along with frequent comprehensive contract meetings between the provider and the council
Schools may choose to leave the contract if a charge is added. The council would need to sell energy procured for them either at a profit or loss depending on market conditions. However, the Provider may be able to accommodate this within the much larger portfolio to avoid this issue entirely.	1	2	No more than 2	Consultation and explanation process with schools highlighting the benefits of a more formal arrangement. The Provider will take into account the potential for schools to leave when taking purchasing decisions to minimise this risk.

11. Financial Implications

There are no cashable savings identified within these proposals as the general trend is towards an increase in prices. The potential increase in spend of 10% that would be at risk would raise costs between years by less than is currently seen anyway due to underlying macro-economic changes and other drivers. For example gas prices have increased or reduced by as much as 20% between years in recent times. This is therefore within the tolerance of business as usual in respect of budget certainty and financial impact.

This gives the Council reassurance that cost prices will not rise above a certain level whilst giving the opportunity to take advantage of falling unit costs.

Budgets would not be increased or reduced as a consequence of introducing this risk cap. If successful the overall spend will be less, and if unsuccessful the overall spend could increase. In both cases the effect will be masked by expected 'natural' variations in unit price and weather conditions which will have a greater overall effect on spend.

12. Legal Implications

The proposal to procure through a public sector framework complies with procurement legislation and therefore the legal implications relating to the procurement are minimal.

A new contract will need to be entered into, and whilst there is likely to be limited room for negotiation on the terms of the contract, the fact that it is a public sector framework means that it is already tailored to the public sector, and is likely to be very similar to the current contract.

13. Options Considered

Options considered have included alternative purchasing strategies to a flexible capped contract. Locked and fully flexible were rejected as outlined in section 3.

Shorter contract lengths were considered and rejected as they do not provide the most beneficial environment to maximise cost savings. Longer duration contracts are currently not available.

The outline business case approved by the Corporate Procurement Board on 8th September 2015 provided the alternative options to the use of a pre tendered public sector framework and the reasons for rejecting those.

The option to exclude schools from using the contract was considered but rejected due to the negative financial and resource impacts on schools and the negative effect it would have on the Council's relationships with schools which has always been to support.

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01/10/2015

Background Papers

The following documents have been relied on in the preparation of this report:
Gas and Electricity OBC 2015 v5.1

Appendices
None