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**REPORT FOR: CABINET**

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<b>Date of Meeting:</b>	19 November 2015
<b>Subject:</b>	Energy Procurement Strategy
<b>Key Decision:</b>	Yes
<b>Responsible Officer:</b>	Venetia Reid-Baptiste, Divisional Director of Commissioning Services
<b>Portfolio Holder:</b>	Councillor Graham Henson, Portfolio Holder for Environment, Crime and Community Safety
<b>Exempt:</b>	No
<b>Decision subject to Call-in:</b>	Yes
<b>Wards affected:</b>	All
<b>Enclosures:</b>	Appendix – EqIA (Equality Impact Assessment)

## **Section 1 – Summary and Recommendations**

This report sets out the energy procurement options and strategy for the period 2016 to 2020 and seeks approval from Cabinet for a new framework contract.

## **Recommendations:**

Cabinet is requested to:

- a. Approve Harrow Council entering into a Framework Agreement with LASER Energy Buying Group (LASER) headed by Kent County Council for the supply of energy to Harrow's corporate sites and schools for a period of four years starting on 1st October 2016.
- b. Delegate authority to the Corporate Director of Community Directorate, following consultation with the Portfolio Holder for Finance and Major Contracts and the Portfolio Holder for Environment, Crime and Community Safety, to enter into the LASER Energy Buying Group Framework for the provision of gas and electricity.

### **Reason:**

To procure energy at competitive rates for the Council's 573 corporate sites and schools through an efficient and government approved process, taking advantage of falls in global energy prices.

## **Section 2 Report**

### **1. Introduction**

- 1.1. The Council's existing gas and electricity contracts cover energy provision until 30<sup>th</sup> September 2016 and therefore a new contract needs to be secured. To avert any disruption in energy supply, the procurement process needs to commence imminently.
- 1.2. Gas and electricity market prices are highly volatile and a long purchase window allows effective monitoring of the wholesale energy market prices and procurement at the best possible rates. Early contract agreement enables the energy supplier to commence purchasing energy on our behalf and respond to market price changes, taking advantage of potential favourable buying opportunities.

### **2. Background**

- 2.1. The Council currently procures energy contracts via Laser, a public sector energy buying group which has considerable buying power, spending over £400 million a year. This provides huge economies of scale and has generated significant energy cost savings for the Council in recent years.
- 2.2. Under the current framework agreement, electricity for metered and unmetered (street lighting) sites is supplied by Npower and gas is supplied by Total Gas and Power. The Council has two gas and four

electricity contracts powering 450 electricity and 116 gas sites. The total energy expenditure for corporate buildings, state schools, academies, street lighting and housing landlord's supplies comes to approximately £4.6 million per annum as summarised in the table below.

### **Summary of Harrow's energy cost, consumption and CO2 emission (2014/15)**

<b>Key Information</b>	<b>Gas</b>	<b>Electricity</b>	<b>Street Lighting</b>	<b>Total : Gas + Electricity</b>
Total number of sites	116	450	7	573
Total number of meters	166	464	7	637
Total annual cost (£)	£1,631,960	£2,266,551	£733,361	£4,631,872
Total annual consumption (kWh)	49,409,469	20,742,966	6,805,612	76,958,047
Total CO <sub>2</sub> emissions (kg)	9,118,863	10,168,824	3,336,315	22,624,003

## **3. Procurement Framework Option appraisal**

3.1. There are three options considered for the future purchase of energy:

### **Option 1 - Procure energy direct from energy supplier/s**

3.2. This option has not been considered as the Council's existing resources are insufficient to deal directly with the requirements of 573 corporate sites and schools requiring management of a large number of energy invoice queries, metering, invoice validation, addressing payment issues, monitoring market trends and new regulations and other relevant support.

3.3. This option is not recommended by the government, has high price risk and requires a specialist energy tendering exercise. This option is not recommended.

### **Option 2 - Procure energy from a selected energy broker**

3.4. There is a regulatory requirement to tender or obtain three or more quotations for the energy supply contract. This can lead to a time consuming and costly procurement exercise with no guarantee in meeting the government procurement recommendations.

3.5. This option is not recommended by the government, has high price risk and requires specialist energy tendering exercise. This option is not recommended.

### **Option 3 - Procure energy by use of Central Purchasing Bodies (CPBs) (Recommended by Pan Government energy project )**

3.6. The CPB are operated by another public sector contracting authority or by an 'agent' that has been appointed to act on behalf of a public sector contracting authority. Crown Commercial services (CCS) and Laser (a division of Kent County Council Commercial Services) are recognised by the London Energy Project (LEP) as Central Purchasing Bodies (CPBs).

3.7. As stated by LEP both energy procurement service providers have met the LEP's Statement of Requirements (SoR), which was developed to assess the capability, capacity and experience of CPBs to ensure that they are able to deliver effective price risk management and value for money energy supply contracts consistently over a period of time.

#### **3.8. Option 3 is recommended for the following reasons**

- The CPBs energy purchasing performance and ability in meeting the customer requirements has already been evaluated.
- The Council can participate in the framework and utilise the flexible supply contracts put in place by the CPB without any requirement to tender.

3.9. Having recommended Option 3 to procure CPB, the next stage is to select a CPB, that can meet our energy procurement objectives in an efficient and productive way.

3.10. The CPBs considered were:

- a) To extend the Laser Flexible framework.
- b) To use Crown Commercial Services (CCS) flexible framework.
- c) To use both CPBs for the Council's energy supply contracts.

#### **3.11. Option (a) is recommended for the following reasons:**

- LEP's performance assessment indicates that both CPBs are performing equally well and there is no evidence to indicate that one of the two CPBs has achieved a better energy buying performance than the other.
- The purchasing performance benchmark, which has been carried out over 2011 – 2014 indicates that Laser's average achieved price in the Purchase within Period electricity basket was £2.58/MWh. That's (4.9%) below the average market price.
- An accurate and efficient invoice service as well as query management are key priorities for most authorities, particularly for Harrow Council who is committed to providing Harrow's schools with a high standard energy service. Harrow's energy

team has benefited from Laser's fully managed services in resolving a large volume of queries in the areas of invoice management, metering, change of tenancy, renewals, transfers and consolidated billing in the required format for our accounts system.

- Centralised bill payment: Laser currently undertake to handle the payment of Harrow's fully managed energy accounts direct to the gas and electricity suppliers within the bill settlement period, normally 14 or 21 days. Laser then re-bill the Council through its own in-house system. This helps in the event of a dispute. Harrow customers can withhold payments to Laser while Laser continue to pay the supplier, thus allowing Harrow's budget holders to retain control while preventing contract conditions from being breached.
- Laser purchases energy on behalf of 115 local authorities and 45 wider public sector bodies with a combined energy spend of over £400 million a year.

## **4. Energy Purchasing Option**

- 4.1. Each energy buyer has a range of options to consider on behalf of the Council to help manage and control costs.
- 4.2. Calculated price risk, the requirement for budget certainty and better financial opportunities are all key considerations in deciding the wholesale energy purchase option.
- 4.3. The most typical approaches are Fixed-Price Fixed-Term (FTFP) and Flexible Procurement & Basket Options

### **Option 1 - Fixed-Price Fixed-Term (FTFP) contract arrangement**

- 4.4. This offers straight forward pricing, securing fixed rates over a restricted timeframe usually for 1 to 3 year duration.
- 4.5. This model of purchasing provides budgetary certainty throughout the duration of contract and helps to avoid potential market volatility during this period. However the main risk is volatility beyond the purchasing point, when the prices could become relatively high and unfavourable just as the contract renewal date approaches.

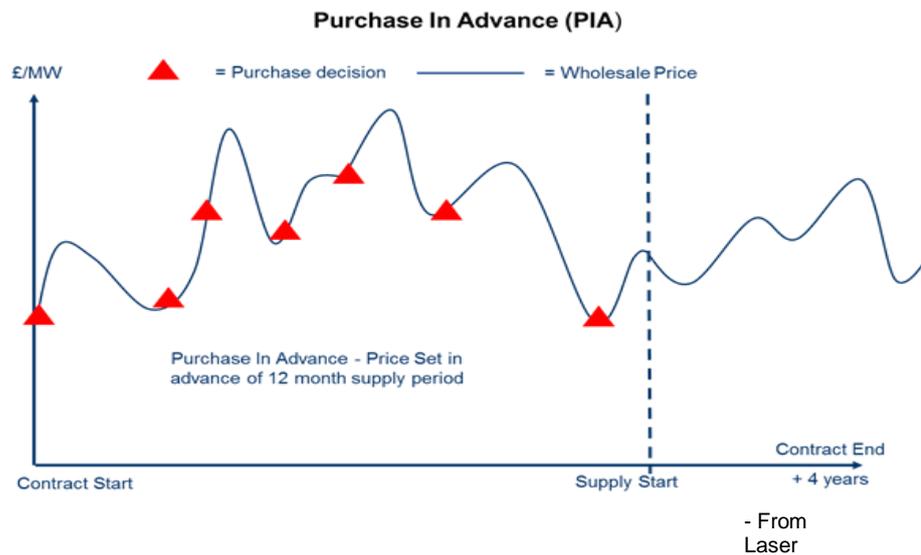
### **Option 2 - Flexible Procurement & Basket Options**

- 4.6. As opposed to purchasing all our energy requirements on one set date, this procurement option helps to spread market price risk and to avoid buying during periods of peak market pricing. Another advantage of Flexible Procurement option is that if energy markets go down during the contract period then we can expect to be paying less for our energy in response to the market movement. However, in certain cases it

could be less attractive for an organisation which wants to have budgeting consistency as some products energy charges may not be known until after that energy has been used.

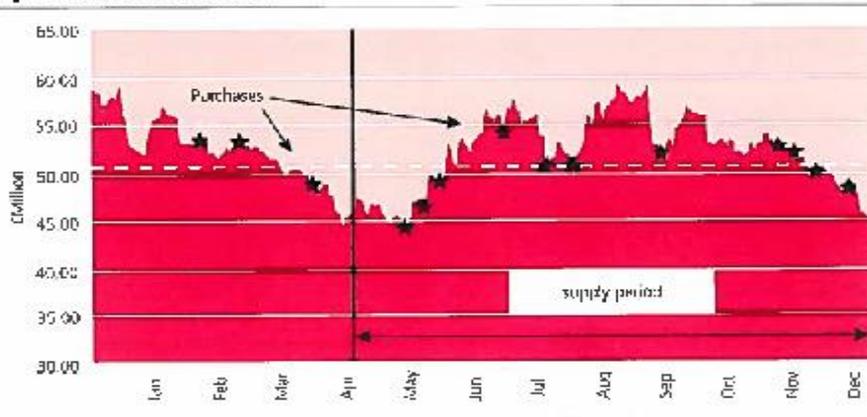
4.7. There are various methods of Flexible Purchasing and approaches. The following options represent typical Flexible Purchasing approaches:

a) Purchase in Advance (PIA) - all required volume purchased in advance before supply period. This provides budget certainty for the following 12 months. The delivered price for a site will be set annually and will be validated and approved by the Energy consortium prior to prices being distributed to us as a customer.



b) Purchase Within Period (PWP) - A proportion of volume purchased prior to delivery. The remaining volume purchased within the supply period throughout the year. A reference price will be set at the beginning of the supply period when open volume is still to be purchased and this reference price will be applied to billing during the supply period.

Fig. 2. Flexible Variable Option



**It is recommended to purchase energy using baskets Flexible Purchase within period (PWP) for the corporate sites and Harrow Schools for the following reasons:**

- Due to the continuing pressure on the Council's budgets and further cuts to local authorities settlements, PWP would be a suitable option as it provides the benefit of potentially lower prices (by getting as close to the marketplace as possible on the month ahead and potentially day ahead indices) with the reduction of the forward risk premium, whilst still ensuring that financial controls are in place by the addition of a 'soft cap'.
- This cap is set at £6/MWh for electricity or 6p/therm for gas supplies, to provide some budgetary certainty with a 95% confidence of positive reconciliation (net payment back to sites). This reconciliation occurs every 6 months in May/June and November/December.

## **5. Renewable energy option**

- 5.1. Currently 24% of the Council's total electricity is supplied from renewable sources, which relates to street lighting and street furniture.
- 5.2. As a result of recent changes in legislation relating to the Climate Change Levy exemption (CCL) applicable to renewable energy, we have been advised on the following options:
  - From 1st Oct 2015 the Council will be supplied from non-renewable energy and CCL charges where appropriate will be applied.
  - Our electricity supplier, Npower, will have some renewable energy available at a premium over CCL of 0.2p/KWh. For clarity, CCL will be applied to this supply and supply is subject to availability.
- 5.3. Therefore, the default position from 1st October 2015 will be the first option unless we wish to pay a premium and still pay CCL.
- 5.4. The additional premium charge of 0.2 p/KWh will increase our total electricity expenditure to about £50,000 during the term of the Council's electricity contract, where we still will be required to pay the Climate Change Levy.

**It is recommended to purchase non-renewable electricity supply for street lighting for 2016 – 2020 to avoid unnecessary costs.**

The decision could be reviewed subject to the change of circumstance and legislation prior to October 2016.

## **6. Laser Energy Procurement Service**

In addition to the core energy procurement services, which Laser's Procurement Only Service offers, they provide a wide range of additional support under their fully managed services which includes:

- Invoice Validation
- Query Management
- Portfolio Optimisation

**Additional Fee:** The fee for the LASER Fully managed Service is recovered by LASER through the p/kwh charge element of the invoice and therefore may vary depending on actual consumption year on year. As a proportion of total delivered costs, a fee of 1.5% is fairly typical.

It is recommended that the Council splits its portfolio between Fully Managed (FM) and Procurement Only Service Option (POSO) services depending on their annual energy consumption and therefore Harrow sites with an annual electricity consumption lower than 64,000 kwh (equates to £7,000) and gas consumption lower than 200,000 kwh (equates to £6,000) are to be excluded from Laser's fully managed service.

## **7. Delegated Authority**

If Cabinet agree to delegate the finalisation of the call off to the Community Directorate Commissioning Services, then the authorising officer would have the scope to review the strategic approach, conduct contract evaluations and award contracts, with formal approvals from Senior Management and following consultation with the PH Finance and Major Contracts and the PH Environment, Crime and Community Safety.

Operating in this way would provide the authorising officer with flexibility for continuous review and operation of energy supply contracts and making a quick decision in response to the market opportunities without a lengthy approvals process.

## **8. Risk Management Implications**

Unlike the Fixed Term Fixed Price (FTFP) option, the flexible procurement arrangement provides a layered risk approach to the purchase of utilities and protects the Council from market volatility seen in 2003/4 and in the period July 2007 – July 2008 where the energy market saw an increase of up to 135%. The reference point, plus 6%, ensures that revenue estimates, if set at this point, will not be exceeded.

## **7. Legal Implications**

- Kent County Council is a Central Purchasing Body and the Contracting Authority for the LASER frameworks. As such, customers do not need to run an OJEU process to utilise the LASER frameworks. Officers are satisfied that the Council, as a local authority, is entitled to call-off from this Framework. The current Laser Framework Agreement ends on 30 September 2016. They have completed a tendering exercise to enable LASER to implement a new purchased energy service from 1 October 2016 for four years.
- The Public Contract Regulations 2015 allow the Council to call off from framework agreements and it prescribes rules and controls for their procurement. Contracts may be called off under such framework agreements without the need for them to be separately advertised and procured through the EU process.

### **Leaseholders**

The Council will need to serve Notice on all leaseholders:

“In accordance with Section 20 of the Landlord and Tenant Act 1985 as amended by the Common hold and Leasehold Reform Act 2002 (the “Act”), landlords are required to give notice to leaseholders and recognised tenants associations of their intention to enter into agreements described in the Act as “qualifying long term agreements”. These are agreements entered into by or on behalf of a Landlord for a term of more than 12 months where any one leaseholder will be responsible for paying £100.00 or more in any one year.”

There are 2 compulsory notices that must be served and a third if the Council does not accept the lowest tender. Each Notice must be served 30 days apart so you should allow ideally 6 months but a minimum of 5 months for this process to take place. If the Council does not serve this Notice it cannot legally recover the full cost of providing communal electricity to leaseholders on the Council’s estates and this will mean a deficit to the Housing Revenue Account.

## **8. Financial Implications**

From June 2014 the price of oil on global markets began to decline rapidly. The fast decline was a result of a number of factors on both the supply and demand side of the market balance. Until supply and demand move closer together it is unlikely that energy prices will recover significantly in the short term. However energy prices can be very volatile and this makes budgeting for energy costs very difficult.

The 14/15 expenditure on energy costs for corporate sites including street lighting was £2.2m in total. Should the prices which the proposed contract can secure be similar to those the Council pays this year, the current energy

budget should be sufficient to meet its costs. There is an energy contingency of £350k set aside corporately, however this is budgeted for up to 2016/17 only. In a longer term, the volatility of energy prices (any upward movement) could present a financial risk to the Council and schools.

## 9. Council Priorities

Making a difference for communities: Harrow's central energy purchasing policy allows Harrow state schools and housing leaseholders to benefit from lower gas and electricity prices.

### Section 3 - Statutory Officer Clearance

Name: Jessie Man	<input checked="" type="checkbox"/>	on behalf of the Chief Financial Officer
Date: 15 October 2015		
Name: Sarah Inverary	<input checked="" type="checkbox"/>	on behalf of the Monitoring Officer
Date: 16 October 2015		

<b>Ward Councillors notified:</b>	NO, as it impacts on all Wards.
<b>EqIA carried out:</b>	YES
<b>EqIA cleared by:</b>	Hanif Islam

**Contact:** Saeed Atlas (Corporate Energy Manager)

**Telephone:** 020 8424 1030 (Ext: 2030)

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**Background Papers:** None

**Call-In Waived by the  
Chairman of Overview  
and Scrutiny  
Committee**

**NOT APPLICABLE**

*[Call-in applies]*