

Committee: Cabinet	Date: June 2008	Classification: Unrestricted	Report No:	Agenda Item:
Report of: Director of Housing Management		Title: Energy Supply Contracts		
Originating officer(s) Sian Pipe		Wards Affected: All		

1. SUMMARY

- 1.1 The Council's current energy supply contracts are due to expire on 30th September 2008. This report recommends a tendering strategy for procuring new contracts addressing both financial and sustainability issues.

2. RECOMMENDATIONS

That:

- 2.1 The procurement procedure, as set out in section 7 of the report, be approved; and
- 2.2 The Head of Property Services after consultation with the Interim Corporate Director of Development & Renewal be authorised to determine the energy supply contract providing best value for the Authority and to agree the Authority's entry into that contract.

Local Government Act 1972 (as amended) Section 100D
List of "Background Papers" used in the preparation of this report

3. Existing Energy Contracts

- 3.1 The Council's energy contracts are due to expire on 30th September 2008. Presently the electricity contract for the small sites is with Electricité de France (EDF) and the gas contract and large electricity sites is with E-on Energy, formerly Powergen. These contracts supply housing estates, council offices/depots, community/social services facilities and most of the Borough's schools.

Budget

- 3.2 The projected annual cost of the contracts are based on the previous year's actual cost, inflated by the price increase advised from market intelligence which becomes the base budget for the next year. This is then further inflated by approximately 6% to account for voids and unrecoverable costs. The contract budget uplift figures are notified to all the directorates through the annual Budget Practitioner's Guide.
- 3.3 During October the budget provision is reconciled, based on the actual spend as at the end of the second quarter of the financial year.

Cost Recovery from tenants and leaseholders

- 3.4 The majority of housing's energy costs are recovered from tenants and leaseholders, as most of the fuel is used by communal heat and hot water systems. Council tenants are advised of their energy costs as part of the annual rent notification. Leaseholders are advised of the estimated energy unit price in their service charge notification, with the actual cost advised after year-end.

4. Procurement process in 2007

- 4.1 In 2007 the Energy Efficiency Unit, in conjunction with the central procurement unit, held an E-auction to procure energy supplies for the Borough. In recent years the energy market has become increasingly volatile, and suppliers are generally only willing to hold their best price offers for a few hours. If the Council relied on traditional tendering the energy suppliers would offer a higher price to reflect their risk in having to hold a price position for more than a few hours. The e-auction is a highly competitive trading method requiring fast analysis of quotations to enable acceptance within 90 minutes of the auction close.
- 4.2 E-procurement continues to be considered to be the best way of meeting the Council's energy needs at the lowest financial cost.

5. Energy Supply Contracts

- 5.1 The gas and electricity markets continue to show a high degree of price volatility based on unprecedented high oil prices. This is a result of a range of international factors which are currently affecting the fuel supply markets.

In terms of both gas and electricity pricing, a lot still remains uncertain. The recent government Energy Policy Review concluded that the power generation sector should diversify energy sources in order to reduce dependence on gas, which could lead to a growth in consumption significantly below current expectations. The continued uncertainty over security and threat of terrorism is a real threat globally. The insurgency within Iraq and the continued violence in the Middle Eastern Countries has increased concerns of a possible terrorist attack on a major oil facility.

The Markets since September 2006

5.2 Electricity

Wholesale Markets

The slight gains in UK Annual electricity prices seen in the second half of July were eroded the month we went to tender, as forward gas, oil and emissions markets have all slackened. October Annual '07 was pegged around £37.5/MWh, with all annuals beyond this then under £39/MWh, this will be known as the 'soft-pedal Summer' – in reference to the relative lack of volatility compared to previous summers.

Supply Markets

The UK's supply margin meanwhile has tightened, with one reactor at the Heysham nuclear plant unexpectedly going offline – as planned maintenance outages have also started at the Connah's Quay, Eggborough and Ratcliffe power stations.

5.3 Gas

Wholesale Markets

The global market for LNG (Liquified Natural Gas) has reportedly tightened following the shutdown of the world's largest nuclear power station – the 8,200 MW Kashiwazaki Kariwa plant in Japan – as Japanese generators have boosted output at gas-fired plants to make up for the resulting loss of supply. The plant shut down after an earthquake hit the region last month and may be out of action until later in the year, helping to shore up international gas markets.

Supply Markets

Annual maintenance programmes at Rough (the UK's largest gas storage site) and in the UK-Belgium interconnector were scheduled to overlap in September but the effect on the market was thought to be negligible. Two major pipeline announcements were expected in September 07, which had a significant effect on the UK gas market. The

Best Value Procurement Procedure for 2008/09

To Appoint an Energy Procurement Service Provider for both Gas & Electricity

In order to comply with the London Centre of Excellence Energy Project guidelines and to minimise risk to LBTH, we expect to appoint an energy procurement service provider on a competitive tender process. We will expect the PSP to extrapolate, build and validate London Borough Tower Hamlets site information to establish a complete estate listing. This will involve carrying out detailed analysis of the current contract standing in relation to the identified estate after which LBTH will be in a position to issue tender instructions to suppliers supported by clean and verified site information with a clear view of current costs. Post contract award services are also detailed as part of this key area.

Manage, perform and implement a tender exercise for LBTH estate using an e-procurement platform, presenting all suppliers with electronic format information enabling them to return offers under real time scenarios. Perform the analysis of these returned offers by detailing not only best offers by price but also deliverability of service as determined by LBTH.

Perform post-contract award services including detailed day-to-day management activity ensuring all meters are registered with the successful supplier, consumption data is collated accordingly and all amendments to the estate tracked and updated in a timely and complete fashion.

7.4 Tender of the Sub 100Kw Sites

In the current market the tender of the Council's sub 100Kw sites, numbering in excess of 2,000, are seen as potentially unattractive due to the inherent administrative costs and the low individual spend per site (generally under £500 per annum). Given this, there could be a significant cost to the Council should the supplier change as:-

- New financial systems will be needed (as each supplier uses a different accounting interface, which would deal with the throughput of c.10,000 invoices annually).
- With so many sites needing to be re-registered it is inevitable that a percentage will fail and officer time will be needed to resolve this. Any sites, which fail to register, will remain with the current supplier until resolved – and be charged at a higher unit rate.

In order to mitigate these costs, it is recommended that the winning supplier must be in excess of £25,056 cheaper than the prices offered by the incumbent. This will be

factored into the award matrix. These costs have been established following discussions with neighbouring boroughs, (who have all had experience of changing Suppliers in last few years).

7.5 **Renewable (Green) Electricity**

The Sustainable Energy Act (2003) sets out the step change required by government to meet energy efficiency targets. As part of its requirements the Secretary of State has now set a new energy efficiency aim: To deliver 4.2 million tonnes of carbon savings from households by 2010. The Act directs Local Authorities to take supporting actions to achieve this aim, and eradicate fuel poverty amongst vulnerable households by 2010. Using renewable (green) electricity is an effective route to part-compliance with the Act as no carbon is released in its production.

7.6 We were able to procure green electricity for both Mulberry Place and Gladstone Place in this 2007/08 contract. We would hope that this will continue next year in order to further benefit the Council by improving the current ratings being achieved at these sites under the EU Performance of Buildings Directive. This new Directive will impact from October 2008 and requires a Building Performance Certificate to be displayed in the foyer of all buildings over 1,000m² in size. The certificate rates the building on an A-G scale and records the building's energy and carbon footprint. To improve the ratings at these sites will require investment in heating and cooling plant, controls and insulation levels. In this context, buying green electricity to secure uplift in the rating is a cost-effective option at both sites. By way of example: - the usual premium for green electricity is around 7%. At Gladstone Place buying green electricity has made approximately a 51% improvement in the site's carbon footprint at a gross cost of £3,021 (or a net cost of £363 when the spot price of carbon is taken into account). This would impact very positively on the environmental rating - moving it from a lower F to at least a D – in a far more cost-effective way than investing in energy efficiency measures to achieve the same impact.

8 **Contract Scale**

8.1 The larger the portfolio for electricity procurement the lower the unit price. In view of this the Energy Team will be continuing to develop its contract customer base, particularly for electricity sites, aiming to purchase energy on behalf of more RSL's, leaseholders and schools.

8.2 To support this a Service Level Agreement (SLA) has been developed to ensure contract energy customers are assisted in managing their energy costs. This work will include monitoring and targeting, energy surveys and an emphasis on reviewing building performance. This SLA will also apply to the ALMO.

9 OJEU Notice

In accordance with EU procurement law a notice will be published in the Journal of the European Union to invite expressions of interest.

10 Delegated Authority

- 10.1 Because of the nature of an e-auction the tendered prices have to be evaluated and accepted within a very short time frame (usually a few hours). It is therefore proposed that delegated authority be given to officers to accept prices and let the contracts in this way.

11 Comments of the Chief Financial Officer

- 11.1 The Authority currently spends in excess of £8.5m a year on gas and electricity supplies. As with other procurement processes, the procurement of energy supplies needs to demonstrate best value. It is important that the Authority continues to track the market and benchmark alternative sources of supply and approaches to procurement. Joint working with schools and outside organisations such as registered housing associations allows better prices to be obtained through bulk purchasing arrangements.
- 11.2 The energy market is highly volatile. The approach set out in the report takes account of the need to manage the risk to the Council of price volatility. A traditional approach would require suppliers to factor in more of the risk of price movement into the price offer; the e-auction reduces the risk of price movement between tender and acceptance with this process being undertaken effectively over the last few years. However notwithstanding the above, Members should be aware that there is a high risk of significant price increases due to the prevailing state of the energy market."

12 Concurrent Report of the Assistant Chief Executive (Legal)

- 12.1 The tendering method outlined in this report complies with the requirements of the Public Contract Regulations 2006 and all applicable EU and UK legislation as well as the Council's own procurement procedures. It would appear to be the best way of achieving best value in the procurement of energy supplies.
- 12.2 The value of the proposed contracts is above the threshold for delegation to a Corporate Director under Financial Regulation B8 and is not a function of the full Council under Article 4 of the Constitution. This matter therefore falls to be considered by the Cabinet.
- 12.3 This is a Key Decision under Article 13 of the Constitution.

13 Equal Opportunities Implications

- 13.1 Obtaining the best value price through e-procurement will ensure that low income households, many of whom are in disadvantaged sections of the community, will benefit from low-cost fuel re-charges.

14 Anti-Poverty Implications

- 14.1 It is proposed that by offering the best possible value contracts this will lead to lower energy charges for our tenants and leaseholders and will assist us to meet our targets under the directive set by Central Government to eradicate fuel poverty by 2010.

15 Sustainable Action for a Greener Environment

To comply with our carbon dioxide reduction targets it is hoped that we will continue to procure green electricity (7.5). To further promote general environmental awareness we will continue to use our SLA to promote one to one climate change issues.

16 Efficiency Statement

Negotiations Summary 2007

12 Month contract length

We elected to accept the 12 month supply offer from Electricité de France (EDF), based on an existing annual value of £2,340,199.90. Therefore, we saw a decrease of 28% over the existing contract value for the 2007/08 contract, which reflects a saving of £655,256 in financial terms.

HHM Contract Negotiations

The HHM negotiations were carried out on the 21st August 2007. We elected to accept the offer from E-on Energy for a twelve-month contract. The decrease over the 2006/07 contract value was 20%, this equates to a new contract value of £3,347,632. Through using the e-procurement platform we were able to achieve a saving of £669,527 over the last years prices.

17 Risk Management Implications

- 17.1 All risks have been identified and appropriately mitigated, as follows: -

Risk Factor	Risk Level	Mitigation
Higher Fuel Costs	High	<ul style="list-style-type: none"> - Appointing an Energy Procurement Service Provider - Timing to market advice
Uncompetitive tender process	Low	<ul style="list-style-type: none"> - Contact made with all appropriate UK suppliers
Speed of tender acceptance	Medium	<ul style="list-style-type: none"> - Agreement of terms and conditions prior to e-auction - Delegation of authority to let contracts
Site registrations following change of supplier	High	<ul style="list-style-type: none"> - Contracts need to be let with a 28 day window to effect new site registration before contract commences - Price premium in place to reflect cost of changed Supplier