


<p><b>Cabinet Decision</b>  <b>(Supplementary Report to the</b>  <b>Contracts Forward Plan Q1 Report )</b></p> <p>5<sup>th</sup> April 2016</p>	
<p><b>Report of:</b> Zena Cooke, Corporate Director of Resources</p>	<p><b>Classification:</b>  [Unrestricted]</p>
<p><b>Procurement Strategy for Contracts for the Supply of Natural Gas and Electricity</b></p>	

<b>Lead Member</b>	<b>Councillor David Edgar</b>
<b>Originating Officer(s)</b>	Abdul Khan, Sustainability & Energy Service Manager / Sian Pipe, Energy Manager
<b>Wards affected</b>	All wards
<b>Key Decision?</b>	Yes
<b>Community Plan Theme</b>	<b>A Great Place to Live</b>

### **Executive Summary**

The final decision on the renewal and procurement strategy of the council's bulk energy supply contract needs to be made by September 2016. Historically the Energy Services team in the Development & Renewal directorate has led the procurement and management of the energy supply contracts. The energy supply contracts include purchasing of natural gas and electricity for all council buildings, street lighting, schools, the council's housing stock managed by Tower Hamlets Homes, and other third party clients.

Since 2009 the council has been procuring energy through the Crown Commercial Services Framework, a framework used by many local authorities and government departments providing access to the wholesale energy market and cheaper energy prices.

Over the last couple of years competition in the energy markets has improved thus providing the opportunity to achieve even cheaper prices for those who are willing to shop around and are flexible in their procurement strategy.

#### **It is therefore recommended that;**

- I) The council continues to purchase for the majority of the contract through the government's Crown Commercial Services framework. This allows the council to comply with appropriate notice periods for changes in energy prices whilst still benefiting from low energy prices through a government procurement framework
- II) It is also further recommended that the purchasing of energy supplies

for sites within the council's direct control (operational buildings, idea stores, street lighting etc.) is purchased through an energy broker. The use of an energy broker provides flexibility and takes advantage of the energy markets, purchasing when there are dips in energy prices, forward purchasing, participating in triad periods, buyback gas contracts and hedge electricity contracts.

The approval of the procurement strategy for contracts for the supply of natural gas and electricity is sought through the Cabinet Report "Procurement Forward Plan". The reference and report title for this contract within the Procurement Forward Plan is DR5025 Council Building Energy Supply and is contained within Appendix 1 of the Procurement Forward Plan being considered by Cabinet on the 5th April 2016.

### **Recommendations:**

The Mayor in Cabinet is recommended to:

1. Note the procurement strategy for contracts for the supply of natural gas and electricity for both large 100kW and smaller Sub 100kW sites for the period from April 2017 for three years until the end of March 2020.
2. Approve that the council continues to purchase for the majority of the contract through the government's Crown Commercial Services framework.
3. Approve that energy supplies for sites within the council's direct control (operational buildings, idea stores, street lighting etc.) are purchased through an energy broker.
4. To delegate authority to the Corporate Director of Development & Renewal to comply with the agreed buying and management strategy for the duration of the contract. This includes the removal of parties or clients in the contract who do not adhere to the terms and conditions of the service level agreement that they enter into with the council.

## **1. REASONS FOR THE DECISIONS**

- 1.1 By no later than 30<sup>th</sup> September 2016, the council is required to make a decision on the procurement strategy for the supply of natural gas and electricity. The local authority is required to have an approved and agreed procurement strategy for the supply of natural gas and electricity to ensure it has control and a degree of budget certainty for the consumption of energy.
- 1.2 It is a critical requirement that the operational buildings and assets are supplied with heat and power allowing the council to continue with its day to day business.

## **2. ALTERNATIVE OPTIONS**

- 2.1 The council can choose not to have a procurement strategy for the supply of natural gas and electricity. This may however result in the local authority paying 'out of contract' energy prices where the current predicted expenditure on energy supply will significantly increase, potentially doubling in cost.

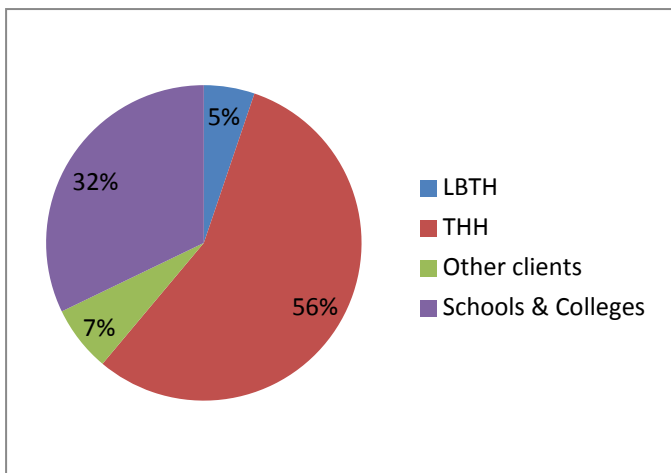
## **3. DETAILS OF REPORT**

- 3.1.1 The Council needs to procure the supplies of Natural Gas and Electricity for its own and its external clients' property portfolios. Such sites include, but are not limited to housing, public buildings, Idea Stores and park buildings.
- 3.1.2 Since 2009 the Council has procured and managed the supply of Natural Gas and Electricity through framework agreements with Crown Commercial Services, (CCS), enabling the Council the flexibility of purchasing on the wholesale market.
- 3.1.3 The current purchasing strategy is based on flexibility, aggregated (with other CCS clients, including central Government), risk-managed procurement, purchasing tranches of gas and electricity on dips in the market and against set trigger prices to ensure budget certainty. All gas and electricity is presently purchased in advance of contract start dates in order to prevent punitive default prices being imposed by suppliers. A flexible strategy of buying over a six month period, with some purchases made near to delivery and some further away, helps to mitigate any sharp increases in market prices.
- 3.1.5 Central Government and the Department of Energy and Climate Change (DECC), along with the London Energy Project and other organisations procuring in the energy sector, recognise and have highlighted the benefits of a flexible purchasing strategy that provides mitigation against the extreme volatility of energy prices.

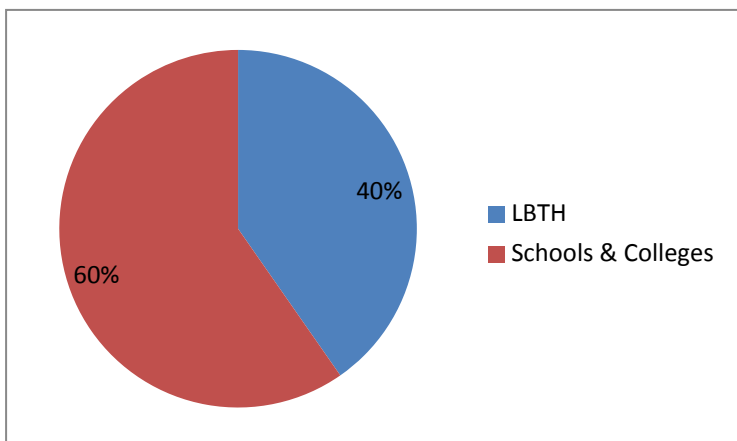
3.1.6 The proposed procurement strategy provides the best opportunity for the Council to access the wholesale market and to maximise savings in a falling market and mitigate against costs in a rising market.

3.1.7 Historically, price benchmarking has proved very difficult due to commercial confidentiality. Price benchmarking against DECC quarterly statistics for industrial and commercial contracts, and gas and electricity benchmarking compiled by the London Energy Project from 31 London boroughs has demonstrated that prices obtained by CCS or other public buying organisations are at least comparable and in some cases significantly lower, although this cannot be used as a direct comparison.

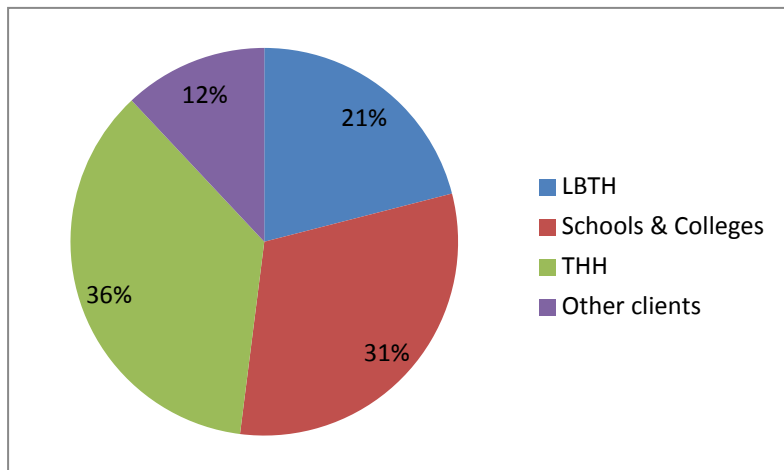
3.1.8 Gas sites (percentage share of expenditure)



3.1.9 Electricity Half Hourly sites (percentage share of expenditure)



### 3.1.10 Electricity Non-Half Hourly sites (percentage share of expenditure)



## 3.2 Timetable

- 3.2.1 Should notice need to be given for a change in procurement strategy, this would need to be communicated to CCS by 30<sup>th</sup> September 2016 otherwise significant penalties will be enforced.
- 3.2.2 To avoid Leaseholder dispensation (section 20) all contracts with relevant sites – i.e. housing non half hourly and natural gas, need to be restricted to twelve months.
- 3.2.3 The tender to appoint the energy broker needs to be published to allow time for evaluation and the eventual appointment.

## 3.3 Considered Options

- 3.3.1 The three options considered for the procurement to supply both Natural Gas and Electricity were as follows;
- 3.3.2 **Option A** – to continue with the framework at CCS currently in place;
- 3.3.3 Crown Commercial Services is a known and respected PBO (Public Buying Organisation). LB Tower Hamlets has been using CCS frameworks since 2009.
- 3.3.4 The London Energy Project (LEP) evaluated the two available PBO's, available to Tower Hamlets, Kent County Council LASER and CCS. The Flex contracts provided by both PBO's provide access to benefits of the wholesale energy market and experienced brokers.
- 3.3.5 Volume aggregation provides some financial benefits, but these are becoming less as the market changes, however they provide access to the lowest quoted prices available at specific trading times and through creating a demand profile that is attractive to energy suppliers and therefore lower in cost. Both PBO's frameworks have favorable terms and conditions, are fully compliant with procurement regulations and their fees and charges are transparent and competitive.

- 3.3.6 Substantial research, detailed analysis and assessment of the entire public sector energy spend through the Pan Government Energy Project and through the LEP demonstrated that Flex contracts delivered some of the best value for the public purse.
- 3.3.7 **Option B** – to use an energy broker, appointed through a tendering process to procure for the entire value of the contract. The tender would be for the cost of the service rather than the amount of the contract and therefore would be OJEU exempt.
- 3.3.8 There are currently many individual brokers offering various degrees of service to local authorities, ranging from fully managed contracts to simply a brokerage buying service.
- 3.3.9 The council's Energy Services team has met with a number of firms offering Energy Procurement, however it was felt that an individual energy broker would not have the resources to manage such a large and complex contract.
- 3.3.10 **Option C** – to purchase for the majority of the contracts through the Crown Commercial Services framework. This allows the council to comply with appropriate notice periods for changes in energy prices whilst still benefiting from low energy prices through a government procurement framework operating on an annual basis.
- 3.3.11 Selecting the correct procurement strategy for the supply of both Natural Gas, and 100kW and Sub 100kW Electricity will have a direct social benefit on the amount residents and leaseholders pay in their rent/leaseholder charges. By purchasing utilities as effectively as possible, we are reducing the financial burden on tenants and leaseholders who are charged for landlord's services in respect of communal lighting, lifts, door entry, heating and hot water (where appropriate).
- 3.3.12 The purchasing of energy supplies for sites within the council's direct control (operational buildings, idea stores street lighting etc.) is undertaken through an energy broker. The use of an energy broker provides flexibility and takes advantage of the energy markets, purchasing when there are dips in energy prices, forward purchasing, participating in Triad periods, buyback gas contracts and hedge electricity contracts. These advantages on routes to market will give greater flexibility to the council to control its changing portfolio and will allow for any adjustments to be made efficiently to the portfolio without incurring additional costs. By entering into longer contracts for both gas and electricity the council will be able to maximise the benefits of a flexible procurement strategy.
- 3.3.13 The size of the contract under the direct control of the council is likely to be approximately £2.7 million from 2017-18, based on current price levels and adjusted for likely energy savings that will result from the proposed street lighting upgrade programme. This is an ideal size for an energy broker to manage on an existing OJEU compliant framework.

- 3.3.14 With the changing energy legislation and adjustments to Government thinking on energy taxation, the control offered by Option C would allow LBTH to take advantage of any green generation offered in the market. The Carbon Reduction Commitment will be phased out in 2019 at the end of Phase 2, the shortfall will be an increase in the Climate Change Levy, and securing some green generation would be a way of mitigating some of this cost.
- 3.3.15 As with previous contracts, buying green electricity will be taken, if offered at a cost neutral price. Consideration will be given to the purchase of green 100% - 50% generated electricity at a predetermined additional unit price, set within the parameters of risk strategy.
- 3.3.16 The Carbon Management Plan sets out plans for the Tower Hamlets estate to ensure all aspects of on-site generation are considered and where possible implemented.
- 3.3.17 At this time it is only possible to consider the purchase of green electricity, as green gas purchase is still at a 500% premium

### **CONCLUSIONS & RECOMMENDATIONS**

The recommended strategy is based on an aggregated flexible, risk managed strategy. LBTH will have the continuity of service and security of future supplies without incurring rising costs associated with deemed supplies. This allows for opportunities in the market to be realised, whilst giving a level of budget certainty through the setting of price trigger points and the ability to sell back any trades made if appropriate.

By entering into contracts for the supply of both Natural Gas and Electricity for more than a twelve month period, LBTH will be able to maximise the benefits of a flexible procurement strategy.

## **4. COMMENTS OF THE CHIEF FINANCE OFFICER**

- 4.1 This report seeks approval for the adoption of the proposed procurement strategy for the supply of gas and electricity for the three year period from April 2017 to March 2020.
- 4.2 The council has procured its gas and electricity supplies via the Crown Commercial Services Framework since 2009. In addition to the use for its own assets, energy is procured on behalf of the majority of schools and colleges within the borough as well as various Registered Providers of Social Housing (RPs). These are mainly the organisations that received elements of the council's housing stock following the various stock transfers that have taken place over recent years.

- 4.3 In 2014-15, the last full financial year for which complete data is available, the Council led energy contract incurred expenditure of approximately £11.7 million. An analysis of the approximate relative costs by user is:

	Gas £	Electricity £	Total £
Council Assets (including Administrative Buildings and Street Lighting)	195,000	2,788,000	2,983,000
Council Housing Stock (THH Managed)	2,186,000	1,352,000	3,538,000
Other Clients (Mainly Social Housing Providers)	273,000	451,000	724,000
Schools & Colleges	1,249,000	3,201,000	4,450,000
<b>Total</b>	<b>3,903,000</b>	<b>7,792,000</b>	<b>11,695,000</b>

- 4.4 The existing energy contract expires in March 2017, and three options have been considered for the procurement of the next three year contract:  
 Option A - continue to let all contracts via the CCS framework  
 Option B - let all contracts via an energy broker  
 Option C - let the majority of contracts via the CCS framework but appoint an energy broker to procure elements of the energy requirement
- 4.5 Details of the suggested options are set out in section 3.3, with the report proposing that Option C is adopted. This option would entail the majority of the contract continuing under the CCS framework but the element relating to the council's non housing assets being procured via an energy broker in order to take advantage of cost savings and efficiencies that can be gained from a more flexible specialist approach. Further details are outlined in paragraph 3.3.12.
- 4.6 The appointment of an energy brokerage service will need to be considered in accordance with the council's procurement procedures. This will follow a tollgate process with ultimate final approval being given by the Competition Board. This approach will mean that the benefits of using an energy brokerage service will be further assessed prior to any contracts being awarded.
- 4.7 Approximately 44% of the energy procurement contract relates to energy usage by external clients - mainly schools, colleges and social housing providers. In order to benefit from the rates negotiated, each external organisation must enter into a Service Level Agreement with the council. As part of the SLA process, the organisations must agree to pay their specific energy bills directly to the energy provider via direct debit. In addition each partner must pay an annual fee to the council. These fees part fund the costs of the Sustainability and Energy Services team.
- 4.8 Prior to October 2014, the council was responsible for initially paying all charges on the contracts directly to the various energy companies with the relevant client organisation then being invoiced for their particular energy consumption. This resulted in a high administrative burden to the council and left it exposed to the risk of non-recovery of costs if disputes arose and bills



were not paid. Negotiations with the energy providers has now lead to improved arrangements being adopted whereby the client organisations are billed directly by the energy providers and are required to pay bills directly to the companies via direct debit. This alleviates the administrative role of the council and means that any disputes or issues of non-payment are now matters between the energy provider and the particular organisation rather than the council. The current arrangements also improve the council's cashflow because it is no longer forward funding the payments to the energy providers in advance of recovering the costs.

- 4.9 The above administrative arrangements mean that the council is only responsible for paying for its own property assets, mainly its housing stock, operational buildings and street lighting. It is however essential that any future contracts entered into with energy companies maintain the direct debit arrangements with the client organisations.

## **5. LEGAL COMMENTS**

- 5.1 The Council has an obligation as a best value authority under section 3 of the Local Government Act 1999 to “make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness”. This obligation extends to the purchase of all goods works and services. The Council meets this obligation by subjecting the purchase to the appropriate level of competition.
- 5.2 The Council is obligated by the Public Contracts Regulations 2015 to submit certain procurements to advertising and methods of procurement in accordance with these regulations. The regulations and the associated EU Directives prescribe how local authorities may use third parties to purchase services.
- 5.3 In any event where the 2015 Regulations do not apply the Council has a duty under the Treaty For The Operation Of The European Union to subject purchases to a reasonable level of advertising using a process which is fair open and transparent.
- 5.4 Broadly speaking, the use of CCS frameworks is generally accepted to comply with the Council's obligations as detailed above, provided always that the Council:
- 5.4.1 Abides by the rules of the framework and
  - 5.4.2 Where only one bidder is selected, the bidder chosen is the one which scored the best under the competitive exercise that was used to form the original framework.
- 5.5 However, the obligations identified above also apply where the Council decides to purchase gas and electricity through a broker.

- 5.6 It is the intention that from time to time throughout the brokerage period the broker will approach the market generally and recommend to the Council the then current best deals available. The Council will then purchase the fuels directly from the supplier under a contract formed directly with the supplier.
- 5.7 Accordingly, the brokerage approach represents two procurement routes.
- 5.8 One procurement route that the Council must follow is in respect of acquiring the broker itself. The brokerage services are likely to be determined services to which the 2015 regulations would apply in full if the purchase is of a value above the appropriate threshold. However, given the value of the services it is unlikely that the cost of the brokerage (not including the cost of the supplies) is likely to be above the relevant European Threshold and therefore falls outside the scope of the regulations.
- 5.9 However, as referred to in paragraph 5.3 the services still require to be tendered in an open and transparent way and also this is required by the Council's own constitution and in particular the Procurement Procedures.
- 5.10 However, the second procurement relates to the acquisition of the gas and the electricity. The intention is that the Broker will approach the market from time to time to obtain quotes for the supply of gas and electricity. In doing so the Broker is in effect running a form of procurement on behalf of the Council. This is considered to be the Council's procurement because the Council is the beneficiary of the supply. The broker simply acts as agent and brings the supplier and the Council together.
- 5.11 Therefore, the methodology used by the Broker to achieve the quotations must also be compliant with the relevant European Law. Otherwise the Council will be in breach of the 2015 Regulations when it enters into the contract.
- 5.12 Therefore, a key part of the evaluation criteria for the acquisition of the brokerage services will be vetting the methodology proposed by the Broker for acquiring gas and electricity prices.
- 5.13 It also follows that the ensuing contract for the supply of gas and electricity is separate from any previous contract made by the Council in respect of either the brokerage service itself or the supply of gas and electricity. Therefore, a new decision must be made by the Council appropriate to the level of spend and in accordance with the constitution prior to entering into each and every subsequent contract for the supply of gas and electricity.
- 5.14 It is unlikely that the proposed changes and methodologies represented in this report will have an impact on the Council's Equality Duty as stated under the Equality Act 2010. However, appropriate consideration and desktop exercise should be undertaken to support this view or otherwise, prior to the implementation of any of the recommendations.

## **6. ONE TOWER HAMLETS CONSIDERATIONS**

- 6.1 This procurement strategy for the supply of natural gas and electricity procures energy for the local authority's requirement and on behalf of other local clients therefore working towards achieving the goals of 'One Tower Hamlets'.

## **7. BEST VALUE (BV) IMPLICATIONS**

- 7.1 Best value will be achieved by ensuring the procurement exercise is carried out in time to avoid any out of contract rates. This process is detailed above and will be achieved using Option C or Option A dependent on an external broker being appointed.
- 7.2 Best value in energy contracts is not always achieved in an aggregated contract, the need for flexibility to market is essential in this volatile energy climate.

## **8. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT**

- 8.1 With the changing energy legislation and adjustments to Government thinking on energy taxation, the control offered by Option C would allow the council to take advantage of any green generation offered in the market. As the Carbon Reduction Commitment is probably being rescinded soon, the shortfall of tax raised will need to be found elsewhere. As it is likely that this will be an increase in the Climate Change Levy, securing some green generation would be a way of mitigating some of this cost.
- 8.2 As with previous contracts, buying green electricity will be taken, if offered at a cost neutral price. Consideration will be given to the purchase of green 100% - 50% generated electricity at a predetermined additional unit price, set within the parameters of risk strategy.
- 8.3 The Carbon Management Plan sets out plans for the Tower Hamlets estate to ensure all aspects of on-site generation are considered and where possible implemented.
- 8.4 At this time it is only possible to consider the purchase of green electricity, as green gas purchase is still at a 500% premium. Some consideration must be given to the possibility that the energy tax positions could change dramatically in the March 2016 budget.

## **9. RISK MANAGEMENT IMPLICATIONS**

- 9.1 Please refer to paragraph 3.5. An agreed and approved strategy will ensure the risk of paying out of contract energy prices has been removed.

9.2 The council procures energy for some third party clients so there is a risk of non-payment by those clients. There are service level agreements in place with all clients. Since October 2014 all clients are placed on direct debit or BACS payments which are paid directly to the energy suppliers. Since the implementation of this method of payment there have been no defaults in payment.

## **10. CRIME AND DISORDER REDUCTION IMPLICATIONS**

10.1 Energy supply is procured for use in street lighting and CCTV's. The use of adequate lighting and CCTV is a crime prevention measure; the renewal of the energy supply contract will ensure the continuous operation of these services.

## **11. SAFEGUARDING IMPLICATIONS**

11.1 There are no safeguarding implications.

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### **Linked Reports, Appendices and Background Documents**

#### **Linked Report**

- None

#### **Appendices**

- None

#### **Background Documents – Local Authorities (Executive Arrangements)(Access to Information)(England) Regulations 2012**

- None

#### **Officer contact details for documents:**

N/A