MAIDSTONE BOROUGH COUNCIL

RECORD OF DECISION OF THE CABINET MEMBER FOR CORPORATE SERVICES

Decision Made: 23 July 2009

Energy Purchasing Arrangements

Issue for Decision

To consider the options for energy purchasing.

Decision Made

1. That the council continues to purchase its energy requirements via the Laser consortium.

2. That delegated authority be given to the Property & Procurement Manager to select the most appropriate tariff for individual sites.

3. That the savings of approximately £20,800 previously achieved by officers and the projected savings achievable through the proposed arrangements be noted.

Reasons for Decision

Background

Expenditure on energy purchasing by the council has increased in recent years to a current level of around £500,000 per year, and the longer term picture is that energy costs will continue to increase. It is therefore important that the council secures good value for money.

Historically, boroughs in Kent have procured energy through the Laser contract which brought about significant savings through aggregation with other local authorities' demand. During a rising energy market, the council was enjoying the benefit of two year fixed price contracts for its gas and electricity consumption. However, this strategy came under pressure with the increasingly volatile markets in 2006, with significant increases in fixed rates followed by a dip in the market leaving the council paying above market rates. Flexible purchasing arrangements were introduced in 2008 to counter the volatility of the markets, but these failed to improve the council's position. A consultant's report suggested that further consideration should be given to a number of options.

Electricity and gas prices tend to be driven by the price of crude oil. However, a drop of 60% in oil prices over the last year has not necessarily led to a similar fall in electricity and gas prices. The effect of a falling pound, the length and duration of the recession and security of supplies are some of the factors that affect the market's view of prices.

The options to be examined as set out in the previous report in March 2009 were:

- Continuing within the current Laser contract arrangement in the longer term;
- Continuing with Laser but moving to a new tariff;
- Moving to an Office of Government Commerce ("OGC") framework;
- Engaging a third party intermediary to procure appropriate contracts; or
- Employing an energy specialist to carry out direct purchasing.

In addition it was agreed that officers would also rectify a number of anomalies in the current arrangements concerning available capacity charges, out of contract sites, standard tariffs and profile changes to achieve short term savings of around £15,000 per year.

Rectifying the anomalies

Following detailed discussions with Laser, the anomalies, which had arisen have been rectified with new tariffs taking effect from October 2009, the earliest date from which these can be implemented. This will result in an annual equivalent saving of just over £20,000. This is in addition to the previous work which led to savings of over £50,000 following a consolidated approach to the management of energy billing within the council.

Employing an energy specialist

To provide value for money, the employment of an energy specialist to carry out direct purchasing of energy by the council would need the savings achieved by the specialist, when compared with alternative methods of procurement, to exceed the costs of their employment. It has been assessed that a professional would cost around £80,000 including overhead costs, which would require them to outperform the market by at least 16% to produce a saving. This is not regarded as realistic given the small volume of purchasing.

Also whilst a specialist may negotiate or procure better deals for some buildings, they won't be able to aggregate the requirements in the same way as a consortium such as Laser or OGC, to get better prices across the piece.

A benefit of employing an energy specialist is their detailed knowledge of tariffs, capacity charges etc., to ensure that buildings are being billed correctly. This can lead to initial savings, but will probably become negligible after the first year after the anomalies have been corrected. Subsequently, it is more a case of monitoring to catch the odd inaccuracy, which can be done with in-house resources.

Third Party Intermediary

A third party intermediary (TPI) is an independent energy consultancy who would procure the council's energy requirements on its behalf. The consultancy would be procured via a competitive tender based on a fee for their services, or a gain/share arrangement based on the savings made.

As with the previous option, a TPI would in all probability be able to secure better deals on some properties but, without the benefit of aggregation of demand, the TPI would not be able to improve on the overall prices achieved via Laser or OGC.

A TPI would also have the specialist knowledge of capacity charges and tariffs, and again any savings would be short term and soon become negligible.

Of the councils contacted, Hastings District Council used to engage a TPI, but have now transferred to Laser. We are not aware of any other district councils employing TPI's.

The estimated cost of employing a TPI is £15,000 year, where the TPI carries out the purchasing and the council validates the bills. On the balance of probabilities it is unlikely that this cost would achieve value for money.

Office of Government Commerce

The Office of Government Commerce ("OGC") offers similar arrangements to Laser, in that they set up four year framework agreements for gas, electricity, liquid fuels and energy management. Separate electrical frameworks are also available for high consumption and low consumption sites. Bill validation and other energy advice are also available via a further framework.

Within the frameworks there are also options for fixed term fixed price purchasing and flexible purchasing.

Several authorities using the OGC framework were contacted, but price comparisons between OGC and Laser for the various frameworks are not possible, as prices are site and time sensitive. Prices are not available direct from the OGC framework without first submitting details of the council's portfolio for inclusion in the next round of pricing which takes place in October.

Views have also been obtained from these authorities regarding their satisfaction with OGC arrangements. These are broadly similar to views expressed by Laser customers.

The information obtained about the pricing of the OGC energy is that customers have to state their intention of being in the contract by the April prior to the October start date. The decision to purchase is made close to the contract start date constraining the ability to take advantage of fluctuations in price. Historical data also shows that there is a tendency for the market low to be around April, so it would seem that the OGC arrangements are unlikely to take advantage of this.

It is understood that separate bill validation services would add approximately 2% to 3% to the cost, but could increase the risk, further adding to the cost.

Laser

The Laser consortium tenders and negotiates prices on behalf of around 70 local authorities in London and the south east of England, including all councils in Kent. It offers a range of services that include fixed term fixed price contracts, flexible pricing contracts and bill validation. Price advantage is sought through the aggregation of demand of all the participants' requirements.

The council currently purchases all of its electricity and gas requirements via Laser on a mixture of fixed term fixed price contracts and flexible pricing contracts. The larger consuming sites are currently on the flexible purchasing contract, the remainder being on fixed term fixed price contracts. Maidstone House, which qualifies for a flexible contract, is currently on a fixed term fixed price contract pending the new round of contracts commencing in October this year.

The consultant's view of Laser's operation of the flexible purchasing arrangements was that their governance arrangements tended to restrict the period of purchase to between April and September, whilst historical evidence suggests that January to March is the best time to buy. Lasers' purchases for the period October 2008 to September 2009 took place within a two week period at the end of September, resulting in a 38% increase for gas and 65% for electricity when compared with the previous arrangements.

There may have been other reasons for the decision to delay, which may have been associated with the expectation that the market had peaked during the summer of 2008 and would start to dip in the autumn. This was not a good start to the much heralded flexible purchasing arrangements introduced last year following criticism of the previous inflexible arrangements.

The lessons of 2008, helped by the current recession, appear to have been learnt with all purchasing for 2009/10 being complete, and 25% to 35% completed for 2010/11. This has resulted in an average reduction of 23% for electricity and 34% for gas, giving an estimated annual savings of £35,000.

For the contract year 09/10 (September 2009 to October 2010) the average price reduction will be 23% for electricity and 34% for gas

compared to 08/09 prices. As the contract year is not the same as the financial year budget savings have been calculated by comparing 6 months of 08/09 prices and 6 months of 09/10 prices and compared to the financial year 09/10 budget, leading to an annual saving of £35,000 (this contrasts to the 08/09 contract year for electricity on the flexible contracts which saw an increase of 65% for electricity costs and 38% for gas compared to the contract year 2007/08).

Bill validation and other services provided by Laser are included in the prices paid for gas and electricity, which add approximately 1.5% to the costs.

Whilst seeking views from Laser users, it became apparent that some of the smaller members of the consortium such as district councils felt that their views were not accorded proper consideration by Laser, which can be dominated by the larger spending County Councils and Fire and Rescue Services. They felt that the twice yearly user group meetings organized by Laser were not an appropriate forum to raise their concerns and deal with queries. It is suggested that a smaller user group representing districts be formed to address these concerns.

Whilst concerns have been expressed about Laser in the past, the continued spotlight on their performance appears to have achieved the desired effect, purchasing plans and customer responsiveness have improved and better outcomes are resulting.

Comparison of the Options

Unlike most purchasing decisions where price and quality of service are available to make a commercial assessment, the decision to purchase energy has to be based on either spot purchasing, or a portfolio decision based on risk.

Spot purchasing requires a proactive approach and a thorough knowledge of the markets and the customer's requirements. This is the area where the energy specialist operates. The advantages and disadvantages of this option are discussed above. It is unlikely, given the size of the council's portfolio, the absence of aggregation and the cost of employing the specialist that this is a viable option.

A portfolio decision to place the council's energy requirements with a third party intermediary, OGC or Laser is a risk based decision as it is not possible to make price comparisons in the normal way. It is more a question of judgment as to which arrangement over a period of time will get the best prices when the associated costs are taken into account.

The energy specialist is least likely to achieve the best saving given their inability to aggregate demand and the cost of their employment. This is followed by the Third Party Intermediary whose fees are lower, but who has no more opportunity of aggregating demand. It is difficult to choose between OGC and Laser. However, Laser's recently improved flexible purchasing regime and a lower cost of bill validation services gives them

the edge. A significant further point worth noting is that carbon dioxide emissions from Laser's current electrical supplier are around 5% lower than OGC's. Laser's current supplier is N Power while the OGC supplier is EDF, both have comparable periods remaining on the contracts at around two years. CO2 emissions from suppliers are calculated from their 'energy mix' i.e. how they generate their electricity and will comprise a mix of nuclear, coal-fired and renewable sources and the proportions are used to determine their 'green credentials'. However, while N Power are the 'greener' of the two suppliers the weighting that will be attached to sustainability at contract renewal is not known at this stage.

Based on the above assessment the savings risk can be expressed in a simple table of comparisons:

Likelihood of overall saving	Energy specialist	Third party intermediary	OGC	Laser
5				*
4			*	
3				
2		*		
1	*			

Conclusion and Recommendations

Given the council's level of expenditure on energy of approximately £500,000 per annum, it is important that energy purchasing arrangements provide value for money and are managed effectively and efficiently.

Whilst there have been reservations about Laser's performance in the past, it appears on balance that they now offer the best option for the remaining three years of the framework agreement, subject to regular reviews of their performance.

It is suggested that Laser should provide comparative performance data for inclusion in these reviews.

Decisions are required annually within the lifetime of the contract as to which buildings should be placed on which tariff. It is recommended that these are delegated to the Property & Procurement Manager.

Alternatives considered and why rejected

Alternatives to the proposed action, and the reasons for not recommending them, have been considered in the main body of the report.

Background Papers

Should you be concerned about this decision and wish to call it in, please submit a call in form signed by any two Non-Executive Members to the Scrutiny Manager by: xxxxxxxxxx.