



Derby City Council

**COUNCIL CABINET**  
**13 July 2016**

**ITEM 13**

Report of the Cabinet Member for Communities  
and City Centre Regeneration

**Energy Framework Renewal / Procurement**

**SUMMARY**

- 1.1 Derby City Council's energy supply contracts are due for renewal in 2016. Both gas and electricity contracts require renewal from 1st October 2016. This report outlines the different options available to the Council.
- 1.2 Energy markets are complex and Cabinet Office and Government guidance "The Pan Government Energy Project" outlines that, wherever possible, all public sector organisations should use energy supply framework contracts. These are set up to procure large volume single supply contracts at better rates than would be possible if partner organisations such as the City Council procured themselves.
- 1.3 Using a Framework costs less than the cost of energy on the open market, removes the risks of exposure to direct market volatility in prices and ensures the Framework purchases the energy using inherent economies of scale which are passed back to us, as ESPO is a public sector owned not-for-profit company run by Local Authorities.
- 1.4 This report identifies Eastern Shires Purchasing Organisation (ESPO) as the preferred regional consortium for renewal of both the gas and electricity contracts based on the outcome of a procurement benchmarking exercise.

**RECOMMENDATION**

- 2.1 To approve the renewal of Derby City Council's electricity and gas contracts through a framework agreement to take advantage of current low prices in the energy market.
- 2.2 To approve the renewal of the Council's electricity contract with existing provider ESPO for the period from 1<sup>st</sup> October 2016 to 30<sup>th</sup> September 2020.
- 2.3 To approve the renewal of the Council's gas contract with provider ESPO for the period from 1<sup>st</sup> October 2016 to 31<sup>st</sup> March 2019 (NB one year earlier than electricity due to ESPO staggering end dates), replacing the current contract with Crown Commercial Service (CCS) which is due to end on 30th September 2016.

<b>REASONS FOR RECOMMENDATION</b>
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- 3.1 The framework approach to procuring energy contracts is proven to be cheaper than alternate forms of procurement. The ESPO framework has proved to be more than £500,000 cheaper over the present 4 year electricity contract compared to the costs if we had used the wholesale market. For the 15 sites using gas, the preferred framework costs are £70,000 per annum less than on an alternative Framework offered by other organisations.
- 3.2 The frameworks considered in this report are fully OJEU compliant, meet our own Contract Procedure Rules, and meets the best practice laid down by central government. Government guidance on best practice is shown in appendix 2. 90% of Local Authorities are now procured through a flexible Energy Framework of this kind.
- 3.3 Using a framework to procure energy removes the risk of buying energy at much higher / volatile spot prices outside the framework.
- 3.4 The preferred framework is financed by a retrospective rebate payable from their suppliers, in proportion to the framework usage
- 3.5 If we did not use a Framework the costs would be increased in a rising market. Through a framework agreement we can “lock-out” changes in price and get a best value day price for a variable specified time period, providing price certainty. Gas is now price volatile while crude oil prices are rising so this certainty provides best value for public expenditure.
- 3.6 The frameworks are compared to the verified market wholesale price. The price achieved comprises of a lower commodity price, a saving through a fixed / flexible approach to commodity purchases to reduce risk, and combined economies of scale through purchases on our behalf as well as other members of the Framework. Like any Framework we are charged on a daily per meter charge, which is standard in energy and the preferred framework is the cheapest.
- 3.7 The preferred framework is believed to offer the best balance between financial cost to the Council and risk.



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Report of the Strategic Director for Communities and Place

**SUPPORTING INFORMATION**

- 4.1 The Council currently procures its Electricity supply through an ESPO Framework (supplier SSE) and Gas supply through the CCS Framework (supplier Corona) and has done since 2012.
- 4.2 Electricity is supplied by SSE and the current service agreement expires on 30th Sept 2016. Gas is supplied by Corona and the current service agreement expires on 30th Sept 2016.
- 4.3 Officers believed that more favourable terms were available than those offered through CCS at renewal and have subsequently explored the opportunities available to the Council to access the energy market and have identified the preferred option

**BACKGROUND & ISSUES**

- 4.4 The Council spent approximately £16.3m on the 15 properties with the largest consumption of gas and electricity for the four year period 2012 to 2016, and therefore a stable and predictable pricing structure for energy procurement is considered essential.
- 4.5 There are three main methods of buying energy:
- a) Traditional fixed price contract. Prices are based on the figure applicable on the date of the offer, which may be artificially high;
  - b) Flexible fixed price contract (which allows the purchase of raw energy to be fixed over a number of trades from the wholesale market);
  - c) Flexible variable price contract (where purchases are made as required, following the trend of the energy market, resulting in little budget certainty).
- 4.6 Derby City Council needs to ensure an effective and compliant energy procurement strategy. Energy is purchased very differently to other commodities and the supplier framework and customer sign up to a 3 way agreement as outlined by one of the framework suppliers:
- **Framework agreement** - a legally binding document between framework and the supplier defining the terms of the relationship and the service the supplier will provide to customers.

- **Customer access agreement** - between framework and the customer which provides delegated authority for framework to purchase energy on behalf of the customer.
  - **Model contract** - between the customer and supplier which allows the supplier to deliver the customer's energy.
- 4.7 The Cabinet Office recommended that all Public Sector organisations adopt flexible / fixed price energy procurement as the best approach to cost reduction and control in the changeable energy procurement market. This needs technical expertise of the energy markets and strongly established experience in the large scale market procurement of Derby City Council's energy
- 4.8 This technical expertise is provided through a purchasing consortium through a framework. They provided high levels of added value. Benefits include:
- The equivalent to having an extra team to call upon,
  - A low percentage rebate in the price paid;
- Better value, as the cost of the relevant consortium resources is shared across organisations using the services. This is around £20,000, significantly less than the cost of the Council employing additional staff to perform this role for us
- 4.9 The price of energy is determined not only by the commodity costs of gas and electricity but also regulated fees and charges. These fees and charges are expected to increase steeply over the next few years. Energy will be a considerable and increasing cost in the future based on the present rising market.
- 4.10 A pan-Government Energy Team in 2010 identified a number of benefits to using framework agreements.
- 4.11 Under a framework agreement, categories of savings over the wholesale market price are identified as follows:
- Aggregation Economies Of Scale
  - Fixed to Flexible Savings
  - Supplier Margin Savings
  - Commodity Purchasing Savings
- An explanation of the savings can be found in appendix 3
- 4.12 Discussions have been on-going between Council Officers and representatives of the following framework providers:
- CCS,

- LASER/CBC,
- West Mercia,
- Yorkshire Purchasing Organisation,
- North East Purchasing Organisation, and
- Eastern Shires Purchasing Organisation.

A background for each of the providers can be found in appendix 1.

4.13 Frameworks were assessed based the cost benefits based on current consumption levels for both gas and electric for 15 key Derby City council properties, plus a range of non-financial factors.

4.14 The preferred framework was deemed to be ESPO for both Energy frameworks due to a range of factors, including:

- Reputation,
- Fully compliant Procurement process,
- In-house Trading functionality,
- Experienced contract support,
- Availability of added value services,
- Helpful responsive staff
- Lowest projected cost.

ESPO also compare information on prices, costs and services that through other frameworks were available at a cost.

4.15 **GAS**

We contacted frameworks regarding gas prices using an illustrative scenario. The response from the preferred framework was detailed, substantive and very quick and backed this up with lots of information. Other frameworks also provided us with information.

- Fifteen Derby City Council sites were selected for exact comparison which were representative of our energy portfolio.
- Over a one year period, using information supplied by the framework providers, the preferred framework was over £73,000 cheaper than the next best provider.
- The preferred framework is £2,972.10 more expensive than the next best framework for daily charge overall for these sites over one year.

- Overall the preferred supplier is £70,000 cheaper than the next best framework provider, for these example sites compared to 2016/2017 prices (gas and daily charges combined – some daily charges are more for the preferred supplier and more for other frameworks but even taking account of this, for each site, overall the preferred framework is cheapest)
- For every site the preferred framework is cheaper for gas, and cheaper for gas and daily charge combined. On this basis the preferred supplier is the clear best choice for DCC,
- We asked some frameworks for a cost comparison with the open market but no response has been received at the current date.

#### 4.16 ELECTRICITY

The same approach was adopted for electricity as for gas. Again, it should be noted that we approached some framework providers and no response has been received to date.

### OTHER OPTIONS CONSIDERED

- 5.1 Officers have explored the offerings available on the market, giving consideration to fees, pricing options, sustainability and added value services. There are a number of options available.
- **Option 1 - Do nothing.** When the current contracts expire all sites would automatically transfer onto emergency rate tariffs but these are not competitive and would therefore be very expensive. This option would therefore not offer value for money.
  - **Option 2 - Direct procurement.** The Council could procure its energy supplies directly without the involvement of any third party specialist consultant advice. The markets and tariff options are complex, however, and this would involve a great deal of officer time to create tender documentation and manage an OJEU compliant procurement process which would be necessary due to the value of contract involved. There is no guarantee that this option would deliver any significant benefits and is against Cabinet Office best practice guidelines. Therefore this is not a preferred option.
  - **Option 3 - Procurement via consultancy/brokerage.** The Council could use an independent energy consultancy to buy the energy contracts. The cost of doing so is in the region of £50,000/year. This would be administratively time consuming and conflicts with Government advice and the practice of a majority of Public Sector organisations, who are making use of established pre-procured energy frameworks. This is not, therefore, considered to be the preferred option.

- **Option 4 - Use a different Public Sector Procurement Organisation, other than the preferred framework identified in this report.** Choosing an alternative framework provider would not offer the lowest cost, risk mitigation and other non-financial support offered by the preferred supplier.

Whilst past performance is no guarantee of future delivery, data obtained from ESPO confirms a consistently competitive performance below average market rates respectively. It is therefore concluded that ESPO as the preferred **framework** represents the best option for energy procurement for the Council and is therefore recommended.

It is worth reiterating that energy prices have proven to be quite unpredictable in recent years. Use of the ESPO framework will ensure that the Council has access to appropriate specialist market advice and will provide a good degree of certainty about energy pricing during the contract periods proposed.

**This report has been approved by the following officers:**

<b>Legal officer</b> <b>Financial officer</b> <b>Human Resources officer</b> <b>Estates/Property officer</b> <b>Service Director(s)</b> <b>Other(s)</b>	Olu Idowu – Head of Service Amanda Fletcher – Head of Finance Communities and Place Liz Moore – Strategic HR Business Partner  Christine Durrant – Strategic Director – Communities and Place Richard Boneham
<b>For more information contact:</b> <b>Background papers:</b> <b>List of appendices:</b>	Phil Derbyshire 01332 640167 phil.derbyshire@derby.gov.uk None Appendix 1 – Implications Appendix 2 – Framework Providers Appendix 3 – Tender Process Appendix 4 – Categories of savings identified under the framework

<b>IMPLICATIONS</b>
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**Financial and Value for Money**

- 1.1 By procuring the Council's electricity and gas supply through the preferred Framework the Council will achieve the lowest cost available at this time, which will enable the Council to continue to operate within its current gas and electricity budgets. It should be noted that pricing structures are indicative and that a firm price cannot be provided until the Council is in a position to enter into contract with the framework, and so the quoted savings are indicative only

**Legal**

- 2.1 Figures from framework suppliers are covered by strict commercial confidentiality

**Personnel**

- 3.1 None

**IT**

- 4.1 None

**Equalities Impact**

- 5.1 None

**Health and Safety**

- 6.1 None

**Environmental Sustainability**

- 7.1 This will directly contribute to the Council's energy efficiency and CO2 reduction aims.

**Property and Asset Management**

- 8.1 None

**Risk Management and Safeguarding**



9.1 None arising from this report

**Corporate objectives and priorities for change**

10.1