

Report of: Executive Member for Finance, Performance & Community Safety

Meeting of:	Date:	Ward(s):
Executive	17/1/2019	All

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SUBJECT: Procurement Strategy for Gas and Electricity supply 2020 – 2024

1. Synopsis

- 1.1 This report seeks pre-tender approval for the procurement strategy in respect of Gas and Electricity supply 2020-2024 – Contract 1819-0150, in accordance with Rule 2.7 of the Council’s Procurement Rules.
- 1.2 The Council needs to procure supplies of Natural Gas and Electricity for its own and external property portfolios. Such sites include, but are not limited to, housing, public buildings, libraries, parks, schools and leisure centres.

2. Recommendations

- 2.1 To approve the procurement strategy for Gas and Electricity supply 2020-2024 – Contract 1819-0150 as outlined in this report.
- 2.2 To delegate authority to award the contract to the Corporate Director of Environment and Regeneration in consultation with the Executive Member for Finance, Performance and Community Safety.

3. Background

3.1 Nature of the service

The Council requires gas and electricity for heating, hot water, lighting and power to its own portfolio of sites (Housing, Offices, Libraries, Parks, etc.) as well as for external clients such as Schools, Academies and Leisure Centres.

The current gas contract with Corona Energy and electricity contracts with Scottish & Southern Energy expire on 31st March 2020. In conjunction with Strategic Procurement a project plan has been devised which envisages awarding contracts in the Autumn/Summer of 2019, in order to allow forward purchasing of the gas and electricity commodity elements to take place.

The current purchasing strategy is based on flexible, aggregated (with external clients), risk-managed procurement, purchasing tranches of gas and power on dips in the market. All gas and electricity needs to be purchased in advance of use in order to prevent gas and electricity suppliers imposing punitive default prices. A flexible strategy of buying over a four-year period, with some purchases made near to delivery and some further away, helps to mitigate any sharp increases in market prices.

3.2 Estimated Value

The Council currently buys gas and electricity for its own portfolio, which are directly paid for, and for other sites such as schools, academies and leisure centres who pay their own invoices from within our contract. The costs for electricity and gas for the Council’s own portfolio are funded from the Housing Revenue Account (HRA) and the remainder from the General Fund (GF).

In order to reduce consumption, usage is monitored to identify wastage. Central Government have instructed electricity suppliers to install Smart Metering onto all supplies to improve the accuracy of billing and to allow analysis of consumption data. The table below show the split in terms of consumption and cost over the 12-month period, April 2017 to March 2018:

Lots	Gas Volume kWh	Electricity Volume kWh
Direct Pay (Council)	95,104,300	28,538,000
Indirect Pay (Non-Council)	31,034,600	16,186,000
Total	126,138,900	44,724,000

The annual spend for 2017/18 for these supplies was:

Lots	Annual Gas Cost (£)	Annual Electricity Cost (£)
Direct Pay (Council)	2,273,000	3,125,900
Indirect Pay (Non-Council)	844,000	1,838,000
Total	3,117,000	4,963,900

It is estimated that the total value for gas and electricity for the four-year agreement will be in the region of £32m - £40m (allowing for market fluctuation). This estimate includes the sites mentioned above that are not owned by the Council and are not be paid for by the Council.

Central Government and the Department of Business, Energy and Industrial Strategy (BEIS), along with other organisations procuring in the energy sector recognise and have highlighted the benefits of a flexible purchasing strategy that provides mitigation against the potentially extreme volatility of energy prices.

Price benchmarking has historically proven very difficult due to commercial confidentiality. Price benchmarking against Central Government quarterly statistics for industrial and commercial contracts and direct comparison in gas and electricity prices with another Council which uses a Public Buying Organisation (PBO) has demonstrated that prices obtained via Islington’s current procurement strategy are at least comparable and in some cases lower, although this cannot be a direct comparison due to timings to the markets and volume purchased.

In order to assess the effectiveness of trades, as well as prices being checked against quarterly government statistics and data provided by another Local Authority (in confidence), trades made are checked against current prices to assess their effectiveness. For example, below are shown the current gas and electricity prices for Winter Season 2018 against the prices secured from the Council’s preferred suppliers for the same period:

Winter 2018 (Oct 18 – Mar 19)	Gas	Electricity
Current Prices (Sept 18)	£70.35 p/p/therm	£71.70 MW
LBI Trades	£52.57 p/p/therm	£49.7 MW
Difference %	34%	44%

This shows that prices have risen considerably since the Council purchased trades covering the Winter 2018 period.

The Council receives market intelligence from multiple sources which is analysed closely before any trades are made. Commodity markets are driven by a large number of variable drivers including, but not limited to, oil, coal and carbon prices, weather conditions, international relations, trade disputes, geopolitical unrest, strikes and government regulation. However, the largest effect on prices is currently Brexit, the uncertainty of which has made markets extremely volatile and has had a direct effect on the value of Sterling, reducing it by around 15%-20%. This has made UK commodity costs higher, as we are a net importer of gas and both commodities are traded in US dollars and Euros, both of which have made considerable gains against Sterling over the past 18 months.

3.3 Timetable

Contracts need to be in place at least 3 months before (and preferably earlier) current contracts expire on 31/03/2020 to accommodate a reasonable buying window before the contract start dates to monitor prices and decide on the term of the flexible contracts.

A long lead-in period is to allow for all statutory tender and standstill periods to be observed and in order to consult leaseholders and obtain dispensation from Section 20 of the Landlord and Tenant Act 1985. The Home Ownership Team have been consulted on this and a lead officer appointed.

The timetable for putting contracts in place is as follows:

Begin Leaseholder consultation – Jan 2019
 Advert in OJEU– March 2019
 Invitation to Tender (ITT) – April 2019
 Tender Return – May 2019
 Tender Evaluation – June 2019

A procurement project plan has been produced in consultation with Strategic Procurement.

3.4 Options appraisal

There are other options available to enable energy to be purchased, mainly joining a framework run by a Public Buying Organisation (PBO). These are used by public sector organisations who do not have the in-house resources and expertise to undertake their own energy purchasing. The main PBO is Crown Commercial Services. If we wished to use them to undertake the sole activity of energy purchasing (they do not manage the contracts, this still has to be done in-house), based on our portfolio, the annual cost would be approximately £110,000.

In-house Procurement (Business As Usual)	Using a Public Buying Organisation (PBO)
<p>Positives:</p> <ul style="list-style-type: none"> • Continuity of supplier (same supplier for 4 years) • Full control over whole process • Fully flexible trading • No PBO fees • Single pathway to obtaining Leaseholder Dispensation • Bespoke award criteria • Ability to form relationships with suppliers over 4 years 	<p>Positives:</p> <ul style="list-style-type: none"> • Part of larger Portfolio with potentially marginally lower prices • Experienced Energy Brokers • Greater opportunity for selling back trades/short buying • Reduce Council officer time in making trades • Shorter lead-in time as no OJEU required
<p>Negatives:</p> <ul style="list-style-type: none"> • Greater Council officer time monitoring markets/making trades 	<p>Negatives:</p> <ul style="list-style-type: none"> • High PBO Fees (£110K PA) • No control over energy trades/budgets forecasting setting • No choice over suppliers

PBOs offer an energy buying service from an existing framework where they purchase the gas and electricity from their preferred suppliers using their purchasing strategy (this is a flexible, aggregated and risk-managed procurement). All contract management functions remain with the Council/client. The cost of using this energy purchasing service would be approximately £110,000 per year (£440,000 over the four-year duration of the contract) based on the fee structure provided by Crown Commercial Services (CCS).

By purchasing via a flexible procurement strategy we have the option to buy varying volumes of gas and electricity and different times, accessing any drops in the market that occur. This variable strategy benefits over buying fixed annual amounts on a single day, as on that single day, prices may be high. Buying on multiple occasions using market intelligence spreads the price risk.

The preferred procurement route is to undertake the necessary work in-house, awarding a four-year contract to the winning tenderer.

By adding external clients to the main contract we are purchasing larger aggregated volumes and earning fee income for providing this service. This collaboration has joint benefits for the Council in terms of fee income and for the clients in terms of potentially better prices by being part of a larger contract and mitigating the costs in undertaking separate individual procurements.

By competitively tendering on the fixed price element of the end delivered price and then purchasing the commodity (gas and power) from the winning gas/electricity supplier on the open commodities market as part of a flexible, aggregated procurement strategy, the Council should have access to the most advantageous prices available at any given time (when the markets are low) and can buy volume strategically (monthly, seasonally, annually, over several years).

3.5 Key Considerations

An effective procurement strategy to buy the supply of both Gas and Electricity will have a direct social benefit on the amount residents and leaseholders pay in their rent/leaseholder charges.

Failure to enter into appropriate contracts would lead to default rates being applied at much higher costs, which would have a detrimental effect on residents.

Any supplier appointed will need to provide an Environmental Strategy, showing what they are doing in order to be a responsible, sustainable supplier.

Within the tender, suppliers will be required to agree to the Council's Specification of Requirements which details specific terms and conditions we require to improve the management of the contract and to provide economies such as paperless billing to prevent waste, payment by direct debit to ensure security of supply/reduce finance resources required, dispute management criteria and provision of market intelligence to assist with the general purchasing strategy.

As the procurement methodology is that recommend by the Business, Energy and Industrial Strategy department, we are adhering to best practice principles.

Suppliers will be requested to provide a breakdown of the fuel mix of their offerings (from what sources electricity is being generated from) and whether any of the gas supplied is intended to come from Fracking operations.

There are no TUPE, Pensions and Staffing implications

3.6 Evaluation

The tender will be conducted in one stage, known as the Open Procedure, as the tender is 'open' to all organisations who express an interest. The Open Procedure includes minimum requirements which organisations must meet before the rest of their tender is evaluated.

The award criteria are based on 100% price. This ensures that the supplier with the lowest non-commodity and supplier margin (along with agreement to the Council’s core Specific Requirements) will be awarded the contract(s). This is to reduce the financial burden on residents/leaseholders.

The end delivered electricity and gas prices are made up of many different elements (more than 15 for electricity alone). These can be summarised as:

	Element	Average % of end delivered price
1.	The Commodity costs – the actual price of the electricity generated at the power station/gas from the gas fields	40% Electricity/65% Gas
2.	The Non-commodity costs – environmental taxes levied by Government, use of systems charges levied by National Grid for using wires/pipes and meters	59% Electricity/34% Gas
3.	The suppliers profit margin	Less than 1%

We have no direct control over the second element, non-commodity costs – these are set mainly annually by government and National Grid. The current tender process evaluates the bids made by suppliers for the non-commodity costs and the supplier profit margin elements in order to select a preferred supplier. The commodity costs are bought once contracts have been let, separately by the Council via the preferred supplier’s energy brokers. This allows for multiple, flexible trades to be made in order to make up the total annual volume required. These trades can be monthly, quarterly, seasonal, annual or even longer. Using multiple trades gives a greater chance of accessing dips in the market.

Only gas and electricity suppliers that have a supply license approved by OFGEM (The Office of Gas and Electricity Markets) will be allowed to tender, ensuring a high level of service quality.

3.7 Business Risks

Due to the extreme volatility of energy markets, the larger the forward buying window, the greater opportunity to secure the best price for the supply. Contracts will need to be approved and agreed by December 2019 to allow for a sufficient forward buying window for the commodity elements, hence the long lead-in time for this procurement.

In addition, Housing is the largest service user within the existing portfolio, therefore the risk with regards to consultation with leaseholders needs to be noted and sufficient time allocated to allow Housing Services to request/receive dispensation.

By purchasing flexibly and with options to sell back trades made, the risks of making a single annual (or multi-year) trade on a day when prices are at their highest is reduced.

By including a 20% volume tolerance in contract documentation, we can add additional sites (either our own or external) to either increase fee income or mitigate the costs of new builds.

3.8 The Employment Relations Act 1999 (Blacklist) Regulations 2010 explicitly prohibit the compilation, use, sale or supply of blacklists containing details of trade union members and their activities. Following a motion to full Council on 26 March 2013, all tenderers will be required to complete an anti-blacklisting declaration. Where an organisation is unable to declare that they have never blacklisted, they will be required to evidence that they have 'self-

cleansed'. The Council will not award a contract to organisations found guilty of blacklisting unless they have demonstrated 'self-cleansing' and taken adequate measures to remedy past actions and prevent re-occurrences.

3.9 The following relevant information is required to be specifically approved by the Executive in accordance with rule 2.8 of the Procurement Rules:

Relevant information	Information/section in report
1 Nature of the service	Procurement of gas and electricity for the period 2020-2024 See paragraph 3.1
2 Estimated value	The estimated value per year is £8-£10 Million, £32-40 Million over the 4-year period. Annual Cost to Council – £5.5-£7 Million Annual Cost to Non-Council £2.5-£3 Million The agreement is proposed to run for a period of 4 years See paragraph 3.2
3 Timetable	Begin Leaseholder consultation – Jan 2019 Advert – March 2019 Invitation to Tender (ITT) – April 2019 Tender Return – May 2019 Tender Evaluation – June 2019 Leaseholder Dispensation – Aug/Sep 2019 Contract Award Report – October 2019 Standstill Period/Award contracts – Dec 2019 See paragraph 3.3
4 Options appraisal for tender procedure including consideration of collaboration opportunities	In-house managed procurement, 4-year contract using Open Procedure. See paragraph 3.4
5 Consideration of: Social benefit clauses; London Living Wage; Best value; TUPE, pensions and other staffing implications	Reduced financial burden to residents LLW not applicable for a supplies contract Flexible Procurement for Best Value No TUPE, pensions and other staffing implications See paragraph 3.5
6 Award criteria	The award criteria are based 100% on price (Non-commodity cost) See paragraph 3.6

7 Any business risks associated with entering the contract	Late contract award/Leaseholder Dispensation See paragraph 3.7
8 Any other relevant financial, legal or other considerations.	None.

4. Implications

4.1 Financial implications:

This report seeks approval for the Procurement Strategy for the supply of electricity and gas for a four-year period between 2020-24. It is estimated that the energy cost during this period will be between £32-£40 million and will be met from existing council budgets and contributions from external clients.

The report recommends procurement option A which continues the current arrangements of using an in-house procurement strategy over the use of a Public Buying Organisation (PBO). Based upon past performance and some limited comparative data option A has a greater financial benefit for the council, however this is no indication of best market performance nor future comparative performance of the two procurement strategies.

4.2 Legal Implications:

The Council has power to procure the supply of natural gas and electricity under section 111 of the Local Government Act 1972 which enables the council to carry out any activity that is calculated to facilitate, or is conducive or incidental to, the discharge of any of its functions. The council also has power to purchase these supplies on behalf of third parties under the general power of competence set out in section 1 of the Localism Act 2011. The Council may enter into contracts for such services under section 1 of the Local Government (Contracts) Act 1997.

In relation to the powers for charging third parties in return for purchasing gas and electricity on their behalf the council may rely on:

- A) Local Authorities (Goods and Services) Act 1970 (LAGS) if the third parties are public bodies for purposes of that act; or
- B) The charging power set out in section 93 of the Local Government Act 2003, if the third parties are not public bodies for purposes of LAGS provided that the charge levied is based on cost recovery; or
- C) The trading power set out in section 95 of the Local Government Act 2003 or section 4 of the Localism Act 2011, if the third parties are not public bodies for purposes of LAGS and the charge levied is based on making a profit for the council. In this case the trading activity would need to be conducted through the trading company established by the council, Islington Limited (trading as iCo), in order to comply with these trading powers.

The Executive may delegate authority to award the contract to the Corporate Director of Environment and Regeneration under the Council's Procurement Rule 16.2.

The proposed contract is a contract for supply. The threshold in relation to supply contracts for application of the Public Contracts Regulations 2015 (the Regulations) is currently £181,302. Contracts above this threshold must be procured with advertisement in the Official Journal of the European Union and with full compliance of the Regulations. The Council's Procurement Rules also require contracts over the value of £181,302 to be subject to competitive tender. In compliance with the requirements of the Regulations and the council's Procurement Rules the proposed procurement strategy is to advertise a call for competition in OJEU and carry out the procurement using a competitive tender process. On completion of the procurement the contract may be awarded to the highest scoring tenderers subject to the tenders providing value for money for the council.

The contract is for a period in excess of 12 months and therefore will be qualifying long term agreements under section 20 of the Landlord and Tenant Act 1985. Accordingly, the council will need to comply with the leaseholder consultation requirements applicable to long term qualifying agreements set out in the Service Charges (Consultation Requirements) (England) Regulations 2003 (as amended).

4.3 Environmental Implications

Electricity and gas purchasing has a significant environmental impact; for electricity the main impact is during the generation stage and around half of the electricity in the UK is currently produced using coal or gas, although this is reducing steadily as more renewables start supplying the national grid (carbon emissions from electricity production in the UK are down 65% since 1990 despite an 11% increase in use). For gas, the main impact is at the usage (burning) stage, contributing directly to carbon emissions. There are also significant impacts related to the extraction of fossil fuels prior to the production/supply of electricity and natural gas.

As noted above, suppliers will be requested to provide a breakdown of the fuel mix of their offerings (from what sources electricity is being generated from) and whether any of the gas supplied is intended to come from Fracking operations. They will also need to provide an Environmental Strategy, showing what they are doing in order to be a responsible, sustainable supplier.

4.4 Resident Impact Assessment:

The Council must, in the exercise of its functions, have due regard to the need to eliminate discrimination, harassment and victimisation, and to advance equality of opportunity, and foster good relations, between those who share a relevant protected characteristic and those who do not share it (section 149 Equality Act 2010). The Council has a duty to have due regard to the need to remove or minimise disadvantages, take steps to meet needs, in particular steps to take account of disabled persons' disabilities, and encourage people to participate in public life. The Council must have due regard to the need to tackle prejudice and promote understanding.

A Resident Impact Assessment was completed on 31st October 2018 and the summary is included below. The complete Resident Impact Assessment is at appendix 1.

- The Procurement Strategy for Gas and Electricity supply (2020-2024) is not likely to be discriminatory in any way for people with any of the protected characteristics.
- The Procurement Strategy for Gas and Electricity supply (2020-2024) is not likely to have a negative impact on equality of opportunity for people with protected characteristics.

There is a potential positive impact for Council leaseholders with the following protected characteristics: age, disability, pregnancy & maternity. This is because leaseholders pay for the amount of heat that they use and that the elderly and very young, pregnant and new mothers and disabled residents are likely to spend more time in the home, therefore require more heating. The Procurement Strategy seeks to obtain the lowest cost gas and will therefore provide a greater saving for those spending more time in the home.

- The proposal is not likely to have a negative impact on good relations between communities with protected characteristics and the rest of the population in Islington. The proposals do not provide any opportunities for fostering good relations.

By looking to purchase gas at the lowest price, heat can be provided to Council leaseholders at a lower cost. This will leave leaseholders more money for other purposes, alleviating poverty for lower income households. Alternatively, low income leaseholders may choose to use cost savings to heat their homes to a higher level reducing the negative impacts of fuel poverty on physical and mental health which affect lower income households disproportionately.

5. Reason for recommendations

5.1 The current contracts for the supply of both Gas and Electricity expire on 31/03/2020. In order to purchase utilities after this date a procurement strategy is required to be in place prior to this date.


By adopting the current existing method of procurement, based on an aggregated, flexible, risk managed strategy, we will have continuity of service and security of future supply without incurring additional costs of using a Public Buying Organisation.

This proposed procurement strategy recommended allows for opportunities in the market to be realised, whilst giving a level of budget certainty and the ability to sell back any trades made.

By entering into contracts for the supply of Gas and Electricity for a four-year contract period, we will be able to maximise the benefits of a flexible procurement strategy and reduce the administrative costs of multiple tenders within a framework agreement.

Appendices

- Appendix 1 - Resident Impact Assessment

Signed by:		8 January 2019
	Executive Member for Finance, Performance & Community Safety	Date

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