

BRIEFING PAPER

SUBJECT: ENERGY PROCUREMENT CONTRACT RENEWAL
DATE: 12 AUGUST 2021
RECIPIENT: OVERVIEW AND SCRUTINY MANAGEMENT COMMITTEE

THIS IS NOT A DECISION PAPER

SUMMARY:

Southampton City Council (Council) procures £9 million of electricity and gas per annum covering all corporate and housing assets. All of the council gas and electricity is procured via the Kent County Council's Energy Buying Group (LASER) as part of a 2016-2021 Flexible Energy Official Journal of the European Union (OJEU) compliant framework.

The current Council electricity and gas contracts will expire on 30th September 2021. This paper proposes to continue the procurement of electricity and gas through LASER from October 2021 utilising their OJEU compliant framework.

The existing contracts are separated between corporate and housing portfolios, then gas and electricity contracts are separated within each of the housing and corporate portfolios. This will continue as part of the recommended route outlined within this paper.

This paper provides evidence of the recommended option to be taken forward from October 2021.

RECOMMENDATION:

A report to approve the recommended route to secure gas and electricity supply contracts from October 2021, for a minimum period of 2 years with an option to extend for a further 2 years via the Kent County Council LASER Framework, will be considered at Cabinet and Council in September 2021. Council will be recommended to approve the following delegations of authority to:

- i. the Executive Director Finance & Commercialism (S151) with agreement with the Executive Director of Place to enter into appropriate Customer Access Agreements through the LASER framework for the supply of electricity, gas and ancillary services.
- ii. the Executive Director Finance & Commercialism (S151) and the Executive Director of Place to procure and award a call off contract under a LASER framework agreement for the Council's (including partners) gas and electricity supplies for a term of up to 4 years for the period 2021-2025.
- iii. Decide on the in-contract purchasing option and additional ancillary services under the LASER framework, including green options, to the Executive Director Finance & Commercialism (S151) and the Executive Director of Place.

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- iv. To procure 'green electricity' on both housing and corporate contracts via the LASER framework.

BACKGROUND and BRIEFING DETAILS:

Who is LASER?

1. LASER acts like a 'buying club', whereby the council joins together with other public sector bodies and the tender of prices on the energy market takes place based on energy supplies worth £450m (approximately 2% of the UK's non-domestic energy demand) rather than with just the Council's £9m. The approach is compliant with procurement regulations (PCR15). LASER provides the aggregated, flexible, and risk-managed approach recommended by Government, and expertise in energy-buying for local authorities.
2. The LASER framework contracts have been awarded to NPower for electricity and Total Gas and Power for gas. These are the Council's current energy suppliers and would provide continuity across the contracts.
3. LASER uses a governance process managed by representatives from its members from London Boroughs, County and unitary authorities. The governance panel helps to set buying strategy and provides an audited record of each buying decision.
4. LASER currently procures energy for over 200 public organisations including 130 local authorities, representing over £450m of energy contracts every year. It has completed the procurement to appoint the energy providers for the period October 2021 to September 2024.

Why the council procure from LASER?

5. The council has procured its electricity and gas supplies in this way since 2009. This provision of energy and procurement services by LASER in the current 2016-2021 contract was previously independently benchmarked and shown to be best value.
6. The aggregation of energy demand from the contracted public authorities within the Laser buying group is attractive to the energy market and promotes the lowest 'cost to serve'.
7. The LASER contract provides flexible procurement which means rather than be tied to the cost of energy at the time of the tender return, LASER buy portions (clips) of energy at the most economical time during the rise and fall in the market. This approach is proven to take advantage of market variation in order to procure at the best price. LASER have delivered, under the procurement in advance option, an average cost of -7.05% and -4.88% for electricity and gas purchasing respectively, less than the market benchmark price between 2016 and 2021.
8. This report recommends that the Council commits to signing a two year with 2 x 12 month tripartite contract rather than signing up to a full (2021-2025) agreement as the two year forward commitment provides greater flexibility to manage changes within SCC's scope, status and assets, at a time of significant change.
9. It is estimated that the benefits achieved through the current LASER flexible frameworks, including through market purchases and aggregation, reduces SCC's energy spend by circa £188k per annum.

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10. The electricity provided by NPower under the LASER framework will enable SCC to procure renewable electricity. The council can procure Renewable Energy Guarantees of Origin (REGO) certificates to ensure that all councils assets are supplied with renewable electricity. The corporate electricity account has been procured under this route since 2019.
11. It is recommended to ensure continuity and visibility that council continues to procure REGOs to cover the corporate electricity contracts and include housing electricity usage from October 2021.
12. Ofgem, the energy regulator, administer the REGO scheme, which provides transparency to consumers about the proportion of electricity that suppliers source from renewable generation. There is an increased cost per unit consumed, with estimated Npower maximum costs shown below. Further information is provided in Annex 1.

Table 1 - Annual REGO Cost distribution between Corporate and Housing

Portfolio	Annual REGO Cost	% of total cost
Corporate	£15,080	0.4%
Housing	£24,160	0.5%
Total	£39,241	0.5%

13. There are also other green power options within the LASER framework that could enable SCC to procure proportions of energy direct from renewable energy generators. These options are summarised in Annex 1. These have the potential to offer a number of advantages compared to the purchase of REGOs and it is recommended that within two years of the contact date a review of the options is undertaken to identify the most effective medium/long-term strategy for supporting the decarbonisation of the supply network.
14. Market liquidity (the availability of raw gas and electricity within the wholesale market) beyond the front 2-3 years is limited, therefore, a rolling two to three year buying window is sufficient to enable LASER to effectively manage price risk on a continuous basis.
15. There are a number of procurement options within the LASER framework that will enable SCC to procure energy using the most effective buying option to suit each meter consumption profile. This will help smooth the risks associated with a fluctuating energy market.
16. Circa 50% of the electricity cost charged to the council comes from fixed and other non-raw energy related costs, which will continue to see significant changes over the coming years. By being part of a central purchasing body like LASER we can mitigate or reduce the risk of price increases, and market volatility, and help to lessen some of the fixed pricing mechanisms more easily, leading to a lower delivered price.

RESOURCE/POLICY/FINANCIAL/LEGAL IMPLICATIONS:

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17. The daily operation of council corporate and housing energy contracts is undertaken by resources located in Property within the Energy and Neighbourhoods Payment Teams. This daily management is spread across 4 FTEs – 2 x Neighbourhood Team (Housing Contract) and 2 x Energy Team (Corporate Contract). The energy contract management covers part of the roles identified. The two teams work closely together and provide support and backup where necessary to ensure the smooth running of the contract. There is also support from the finance teams where required. The Energy Team are responsible for the procurement of the contract.
18. Energy related invoicing has been centralised and is managed electronically. This has significantly reduced administration of the contract.
19. The team deliver the energy managed service to corporate sites, including all leisure centres under the Active Nation contract and schools. This service includes centralised payment, bill validation, contract management, management of billing and existing metering queries. It involves ensuring costs are managed and savings identified as part of the service. This service has identified and delivered £800K of savings to the corporate gas and electricity contract over the lifetime of previous framework 2016 to date. On the corporate energy account only, this will be offset by approximately 1.5% fees which the council levies to energy costs to cover the added value energy managed services delivered as part of the contract management.¹
20. Based on current consumption, under the new framework, LASER's procurement only management fees would be approximately £85k (less than 1%) per annum (subject to CPI increases).
21. Green City implications - The LASER energy supply frameworks have been drawn up to serve public sector organisations, many of whom have declared a climate emergency. As such, they have been specifically designed to provide a large degree of flexibility to the customer, within the contracted period, to allow a range of actions to be taken that will reduce its carbon emissions. Under the LASER framework a green tariff can be selected in advance of the 2021 supply period start – or at any point thereafter for subsequent supply years within the contract. There is currently much debate around the additionality and climate change benefits of such an approach however, and the LASER framework also provides significant flexibility to take further decisive and ambitious action to reduce the Council's carbon emissions in line with any recommendations from the Green City Programme Board.
22. Flexibility to reduce purchased energy volumes significantly: One of the most effective means of reducing carbon emissions is to reduce grid imported energy consumption significantly (through investment in energy efficiency projects and/or self-supply from on-site renewable energy installations). Many energy supply contracts contain punitive terms ('take or pay clauses') which penalise customers for significant reductions in purchased volumes (typically in excess of 10% volume variation). Due to the flexible procurement strategies employed by LASER, their large portfolio and longer-term supply periods, it is able to absorb variances in volumes and in doing so critically provide the flexibility for the customer to reduce its purchased consumption significantly. This is considered to be a major benefit of the LASER contract over

¹ This includes monitoring of energy consumption for reduction purposes, electronic invoice payment & management, price checking and validation, along with contract and query management.

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alternative arrangements, paving the way for decisive action on energy and carbon reduction.

23. Energy market price volatility has increased substantially since January 2021. This has pushed gas and electricity prices up to an all-time high and has a bearing on the prices secured from October 2021, which will be the contract pricing start period. Energy is sold in the market like any other commodity, which means we are at the mercy of the price at the time of entering the market. That is why the flexible procurement route has always proved to be the least risky purchasing strategy for the council. See procurement from Section 25 and risks outlined in Section 35 below for further information.

TIMESCALES & PROCUREMENT

24. Timescales – The decision paper to award contracts will be taken to Full Council in September 2021 to ensure we secure contracts before the new pricing period from 1 October 2021.
25. Procurement – The two market options that the Procurement Business Partnering Team explored were; run an Open Find a Tender Service (FTS) procedure or utilise a framework. The Open option for all supplies has been ruled out as the Council’s commitment alone would not attract a favourable economy of scale. There would also be an additional cost from procuring a broker to leverage the market on the Council’s behalf. This option didn’t offer any value for money and would be a time-consuming and costly exercise. The Council will gain a greater benefit from an established framework which it can call off from as part of a commitment cohort with similar organisations. This will allow the Council to achieve better pricing for its gas and electricity. Of those available, the LASER framework demonstrated best value and aligned to the Council’s objectives. It also provides a fantastic future option for the Council to explore “Green” baskets as part of the Green City Programme.
26. Total costs of energy in financial year 2019-20 is shown in Table 2 below. Costs of energy during 2020-21 have reduced due to the impact of Covid 19, meaning site closures or reduced occupation.

Table 2 – Total Council gas and electricity costs.

PORTFOLIO	UTILITY	COST
Corporate	ELEC	£3,488,312
	GAS	£744,182
	Total Corporate	£4,232,494
Housing	ELEC	£4,501,261
	GAS	£241,410
	Total Housing	£4,742,671
	Total	£8,975,165

27. Within the contracts there are several different purchasing options which balance cost against risk.
28. Historically all housing and medium to low consuming corporate sites are within the ‘Purchase in Advance’ (PIA) option (basket). This means all energy is purchased at intervals prior to the pricing start date, which was historically 1 October each year. This gives a fixed price electricity and gas price certainty over a twelve month period.

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29. The larger consuming meters have been procured on a 'Purchase within Period' (PWP) option. This is where a proportion of energy is purchased pre pricing period with the remainder being purchased (circa 20%) within a six month pricing period. A fixed price is charged within each six month pricing period with a reconciliation at the end of each period. As price volatility is high and the outlook also looking volatile, its proposed that the purchase in advance basket is chosen for all meters. This will provide a lower risk basket that will provide more price certainty within each financial year. There has also been some confusion from service areas on the six monthly PWP pricing periods, which have meant significantly higher winter prices and lower summer prices.
30. It's also proposed to move the annual price period from October to September to April to March. At the moment a fixed energy price is provided from October for either six (under PWP) or twelve (under PIA) months. But moving forward the fixed price will be set over a financial year (April to March) as requested by our schools and finance during a consultation process. This means that the first six months of the contract from October 2021 will be procured on a fixed term fixed price route.
31. There is also the option to procure ancillary services under the framework, such as metering, data and wider energy services. The council will utilise these services if it is cost effective to do so. Historically metering and data has been procured via these arrangements. However, these will be procured separately if there are better value alternatives.

RISK MANAGEMENT IMPLICATIONS:

32. Risk has been identified as high in relation to Financial and Green City Policy:
 - Failure to enter gas and electricity supply contracts runs the risk of facing out of contract pricing, which can attract premiums in excess of 100%.
 - The energy market has seen significant rises on gas and electricity wholesale prices on both the spot and forward purchasing market. At the time of writing market prices for gas and electricity are at all-time highs and this is going to affect the price of energy supplied to SCC from October 2021. A purchasing strategy is being assessed for the year ahead from October 2021 which will hopefully reduce the impact on the council, but gas and electricity prices will rise from October. At the moment it's impossible to quantify this increase but it will very likely be in double percentages figures on all supplies. Cost rises will be reported in November 2021 once prices are validated and finalised for the year ahead from October.
 - Locking into certain contracts can also penalise future energy reductions, making them uneconomical and effectively blocking significant potential future cost and carbon reduction activities. Furthermore, failure to enter supply contracts in advance, minimises the window for forward buying and within that market opportunity.

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Annex 1 – Green Electricity Future Contract Options

1. **Flexibility to utilise/purchase energy directly from renewable energy installations**

A means of reducing an organisation's carbon emissions is to purchase renewable energy directly from a known off-site installation (e.g. a solar farm in Hampshire or anywhere else in the country). The LASER framework has been set up to facilitate such arrangements via specialist flexible mechanisms such as sleeving or Power Purchase Agreements. LASER is actively promoting collaboration between its customers to increase development and subsequent benefits from new renewable energy installations. This may range from providing land, to investing in an installation, to selling renewable energy to other customers or to simply committing to purchase renewable energy from an installation. The end result of this is additional renewable energy generation – as is urgently needed to mitigate against further climate change. Critically, energy purchased under such arrangements can be seen as additional and is therefore less likely to be challenged if reported as zero carbon. If decision makers wish to progress this option, it is recommended a detailed assessment is undertaken post contract signing as the timelines required to agree terms on a power purchase agreement will take us past 1 October, when contract renewal needs to be in place.

2. **Flexibility to purchase a green tariff**

A course of action the Council currently uses for its main corporate assets to address the climate emergency is to purchase electricity via a "green tariff". Under such tariffs, for every Megawatt hour (MWh) of electricity purchased for a customer, the supplier also purchases a Renewable Energy Guarantee of Origin (REGO) certificate, which is issued by Ofgem for every MWh of renewable electricity fed into the grid. As such REGOs are traded in a secondary market to the main energy commodity at a fraction of the price. In its assessment of the value of green tariffs, Ofgem stated that it has seen no evidence that green tariffs "could materially support the production of renewable energy over and above what is already in place." Further to this there is a lack of consistency and clarity in guidance for organisations reporting their carbon emissions. The Government's latest guidance for its own departments specifically precludes counting energy purchased through a green tariff as zero carbon. This would appear to limit the benefits of adopting such green tariffs. That said, under the LASER framework a customer may choose to pay a relatively small premium to adopt a green tariff. This has been selected previously under the existing contract for the corporate portfolio only. A consultation is being undertaken within the housing portfolio to assess the option for future electricity contracts to be supplied by green tariff under a REGO arrangement. This option can be selected in advance of the contracted period or prior to any given supply year within the contract, if considered appropriate via the consultation process (e.g. as a short-term measure or following updated Government guidance).