

TONBRIDGE & MALLING BOROUGH COUNCIL

CABINET

22 June 2011

Report of the Central Services Director

Part 1- Public

Executive Non Key Decisions

1 FLEXIBLE PROCUREMENT OF UTILITIES 2012 – 2016

Summary

This report recommends that the Council enters a new four year flexible procurement agreement with LASER for the supply of electricity and gas for the period 1 October 2012 to 30 September 2016. The recommendation is based upon the financial savings achieved under the current flexible procurement contract in place since 1 October 2008.

1.1 Background

- 1.1.1 Cabinet may recall that in late 2007 it endorsed a recommendation to enter a flexible agreement to procure utilities within an EU tender framework agreement entered into by LASER. Decision Notice D070200CAB refers.
- 1.1.2 LASER is a part of KCC Commercial Services and is the largest local authority energy purchasing organisation in the UK. LASER acts on behalf of more than 100 local authorities with combined purchasing in excess of 6 terawatt hours (TWh) per annum. This gives LASER the critical mass required to maximise value for its members. The existing contract commenced on 1 October 2008 and expires on 30 September 2012.
- 1.1.3 Key contracts sourced by LASER on behalf of TMBC include the council offices and all three indoor leisure sites operated by the Leisure Services Business Unit (LSBU). The highest consumption is at Larkfield Leisure Centre and Tonbridge Swimming Pool. The combined cost of gas and electricity per annum for the LSBU is approximately £490,000 and for the Council's main offices at Kings Hill and Tonbridge approximately £94,000. These figures are based upon the 2011/12 revenue estimates. Although this arrangement only currently applies to our larger sites, we would intend to migrate appropriate smaller volume contracts to this option as and when they come up for renewal.

1.2 Flexible Procurement

- 1.2.1 A recent Extraordinary Meeting of LASER member was attended by the Leisure Contracts Manager, Building and Facilities Manager and a representative of Legal

and Financial Services. The LASER team presented a proposal for a further four year contract with suppliers already sourced by LASER through an EU framework tender process. LASER have tendered upon the basis, not solely of lowest management fee, bearing in mind that around 85% of the cost will be driven by the wholesale price of utilities, but other criteria including trading desk performance, market intelligence sources and purchase of renewables. The contract will be signed in July 2011 to allow seasonal purchasing to commence with the supply period starting on 1 October 2012 until 30 September 2016.

- 1.2.2 The new contract will operate in similar fashion to the existing agreement with a reference point price set for each customer annually which would represent an average of the market price over the preceding 12 months plus a predetermined premium, normally between 0% and a maximum of 6% to provide market capital for the buyers. LASER then buy energy through the suppliers trading desk on a seasonal, quarterly and month in advance pattern to achieve a flatter, middle market price strategy objective. The accounts are reconciled every six months with rebates paid to the Council. At the anniversary of the contract each year a revised reference point is set.
- 1.2.3 The principle advantage of the flexible procurement model is the ability to hedge the market, providing far greater stability of pricing over a longer period. LASER recognises that it will not deliver lowest price but purport to the model managing the financial risk in a far more controlled manner.
- 1.2.4 A summary of the advantages/disadvantages of flexible procurement in comparison to a contract of Fixed Price and Fixed Term (FPFT) is tabulated below. This analysis is supported by the Regional Centre for Excellence in its recommendation that flexible purchasing of energy at a variable price is the most appropriate form of procurement.

Fixed Price Fixed Term	Flexible Procurement
Advantages <ul style="list-style-type: none"> • Known costs • Ability to budget accurately based upon usage history • May deliver below market rate for fixed term 	Advantages <ul style="list-style-type: none"> • Longer period to optimise purchasing • Removal of forward market premium • Opportunity to benefit from market falls • Access to short term markets • Layered risk • Will deliver overall costs close to middle market over the term • Avoids huge fluctuations between contract periods
Disadvantages <ul style="list-style-type: none"> • Forward market premium applied 	Disadvantages <ul style="list-style-type: none"> • Unknown final cost • Set billing rate • Final price could be higher

<ul style="list-style-type: none"> • May deliver above market rate for fixed term • Short 'offer' window • High risk • May result in huge fluctuations between consecutive contracts 	
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1.3 Performance of Current Contract

- 1.3.1 The Council had two options when joining the flexible procurement framework agreement. Firstly, Purchase In Advance (PIA) which involves LASER purchasing all of the Council's requirements prior to the supply year 1 October through to 30 September deriving a fixed price for the period. Secondly, Purchase Within Period (PWP) where purchases are undertaken prior to and within the supply period October - March and April – September with price reconciliations being undertaken at the end of each supply period. PIA offers less flexibility than PWP, particularly in the sense of being unable to take advantage of market falls and, therefore, the layering of risk. The Council opted for the PWP strategy under its current contract with LASER.
- 1.3.2 The existing contract has delivered significant rebates to the Council. The total level of rebate to the three indoor leisure facilities and the council offices to date has been in excess of £230,000.
- 1.3.3 In addition to this financial measure of success the Efficiency and Reform Group within the Cabinet Office has issued an analysis of the energy purchasing performance of LASER compared to a market average of prices for a two year period from April 2009. The illustrations at **[Annexes 1 and 2]** to this report show that LASER has outperformed the benchmark price in the PWP contract for electricity by 20% and for gas by 30% over the two year period. It should be noted from the annexes that this is significantly greater than the PIA strategy performance. This represents a saving to the LSBU over the measured two year period of almost £240,000 against market average and, therefore, the saving over the life of the contract may well be close to £¹/₂ million.

1.4 Timescales

- 1.4.1 The Council has until 30 June 2011 to advise LASER of its commitment to enter the new 4 year framework agreement. Upon this advice LASER will draw up a specific tripartite side agreement to formalise the agreement under the framework. This meeting of Cabinet is being held within eight days of the LASER deadline for commitment. It will, therefore, be necessary to set aside the normal call-in procedure (as allowed under Overview and Scrutiny Procedure Rule 15(i)) as any delay would prejudice the Council's interest in taking advantage of the flexible procurement arrangement.

1.5 Legal Implications

- 1.5.1 The proposed contract arrangement has been procured through an EU Framework agreement, naming TMBC as a benefactor of the contract. The Council can purchase under this Framework contract in line with its Contract Procedure Rules.

1.6 Financial and Value for Money Considerations

- 1.6.1 The flexible approach provide by the PWP contract option has proven to ensure, over the long term, a cost of gas and electricity better than middle market prices. The approach is designed to ensure a purchasing pattern that takes advantage of market conditions and avoids the huge fluctuations that can be delivered through fixed price arrangements. The arrangement has brought significant savings to the Council over the term of the current contract. Appropriate smaller volume contracts will migrate to this flexible arrangement when appropriate to maximise savings.

1.7 Risk Assessment

- 1.7.1 The flexible procurement arrangement under a PWP option provides a layered risk approach to the purchase of utilities and protects the Council from market volatility seen over previous FPFT contracts.
- 1.7.2 However, whilst a longer period is created within which to optimise purchase prices, the final cost of utilities under such a flexible arrangement can never be known and could be higher than a fixed price agreement due to unknown advance market factors.
- 1.7.3 Flexible procurement, managed by an approved Public Sector Buying Organisation is recommended by the Pan Government Energy Review Project (part of the Cabinet Office) and provides lower risk to the Council.

1.8 Equality Impact Assessment

- 1.8.1 See 'Screening for equality impacts' table at end of report

1.9 Policy Considerations

- 1.9.1 Business Continuity/Resilience, Procurement.

1.10 Recommendations

- 1.10.1 It is RECOMMENDED that;
- 1) the Council enters the new flexible procurement agreement with LASER using the Purchase Within Period option for the supply of electricity and gas for the four year period 1 October 2012 to 30 September 2016; and

- 2) in accordance with Overview and Scrutiny Procedure Rule 15(i) the normal call-in procedures be set aside to allow commitment to the LASER contract by the 30 June 2011 deadline.

Background papers:

contact: Martin Guyton
John DeKnop

Minutes of LASER Extraordinary Members Meeting
dated 2 March 2011
LASER Publication – A Clearer View
File Reference MG211

Julie Beilby
Central Services Director

Screening for equality impacts:		
Question	Answer	Explanation of impacts
a. Does the decision being made or recommended through this paper have potential to cause adverse impact or discriminate against different groups in the community?	No	Utility supply contract with no associated equalities issues.
b. Does the decision being made or recommended through this paper make a positive contribution to promoting equality?	No	As above.
c. What steps are you taking to mitigate, reduce, avoid or minimise the impacts identified above?		

In submitting this report, the Chief Officer doing so is confirming that they have given due regard to the equality impacts of the decision being considered, as noted in the table above.