# Decision making in energy procurement

The energy market is extremely volatile, with prices varying significantly on a daily basis and dramatic rises being seen over the last 12 months: an 85% price increase against last year is anticipated[1]. You can manage these risks and control costs by adopting the recommendations issued by the LCE Energy Project and considering the following:

## Does my organisation realise there are significant risks involved in buying energy?

Wholesale energy prices are influenced by a range of factors including supply security, weather trends, exchange rates, European prices, geopolitical issues, market sentiments and so on. This complicated mix can result in price volatility of 5-10% over the course of a few days.

## Do we have a risk strategy for controlling energy costs?

Purchasing annual or longer term energy supplies on a single day is a high-risk strategy, with a 1-in-220 chance (220 working days in the year) of getting the best price. Purchasing the same energy requirement, but instead buying ‘chunks’ over multiple trades and over longer periods of time (known as flexible procurement) avoids the high-risk strategy of single day purchasing. Flexible procurement enables the adoption of a robust risk management strategy that can mitigate the price risks inherent in the current energy markets.

## How do we adopt flexible risk managed procurement?

You can adopt flexible risk managed energy procurement by migrating your energy volumes onto one of the professional buying organisations’ contracts recommended by the LCE Energy Project. These are:

- Laser’s flexible gas and electricity contracts only,
- OGCbuying.solutions’ flexible gas and electricity contracts

Managing a flexible energy contract is a specialised function, and should only be performed by market specialists with the relevant knowledge, experience and information to undertake this task. You would not expect your pensions manager to trade the Council’s pension fund on the stock market, and as energy commodities are even more volatile than the FTSE 100, similar principles should be applied to buying energy. In addition, there are minimum size requirements for buying wholesale energy flexibly with an aggregated contract the size of at least 10 typical London boroughs adding the most value.

## What are the benefits of aggregated flexible, risk managed contracts?

In highly volatile markets, such as energy, adopting a hedging strategy through an aggregated flexible contract avoids fixing prices at the highest points in the market. Over the past three years public sector organisations that have been operating flexible contracts have delivered 5% cost reductions against the wholesale market average, a cost reduction that is passed directly on to their customers. In addition, by buying direct from the wholesale

[1] Source: Office of Government Commerce

market and by aggregating volumes, these organisations can reduce costs in other areas, such as the supplier's cost to serve. This can lead to an additional 5% saving for customers.

## How do we define our appetite for risk?

Public sector professional buying organisations (PBOs) offer a range of risk strategies from which you can choose, depending on your organisation's appetite for risk and need for cost certainty. Some of these strategies enable flexible buying prior to the supply contract start date and therefore an 'average' price is calculated and you will receive a fixed price providing the same budget certainty as a fixed price, fixed term deal.  Other strategies buy energy flexibly both before and during the contract period, therefore you will receive an indicative price, but reconciliation at points during the supply period will be necessary.

The PBO will be able to discuss their various risk strategies with you, to ensure you fully understand how the risks are being managed. Senior managers and chief officers should be involved in these discussions, and in assessing **your organisation's appetite for risk** and budget certainty.

## Have we considered the costs of tendering for energy in-house?

The OGC has estimated that the cost of going through the OJEU process is £30,000. By using a PBO, your organisation will not need to go through the tendering process, thus saving time and money. In addition to this, you will no longer have to follow the markets, or take difficult decisions over when to buy. The ability to react quickly to market falls or rises will assist in achieving better prices and PBOs dedicate significant resources to doing this on a daily 'real-time' basis.  By using a PBO to undertake the expert job of market analysis and energy buying, your staff can focus on other important local issues, such as controlling cost, energy efficiency and carbon reduction through developing and implementing energy strategies.

## We use a private sector consultant to buy energy flexibly, what does this mean for us?

The current recommendation from the LCE is to use either Laser or OGCbuying.solutions flexible contracts, as these have been evaluated and have demonstrated that they meet that current best practice in energy procurement.  If you are using a private sector third party (TPI), you would need to be sure that you are getting the best value through a truly aggregated, flexible contact, with full price transparency of all costs, including TPI fees and any commission paid by suppliers to the TPI.  Unless they aggregate your volumes, the TPI cannot access the wholesale market on your behalf and you will only receive prices based on your supplier's view of the market.

## Who should be involved in changing our energy procurement strategy?

Depending on how your organisation is structured, energy management and procurement units should share knowledge and skills to inform any decisions. Additionally, it is advisable to involve your finance department early in the process, so they fully understand the business case for change, and the impacts energy prices can have on budgets. **Senior manager, chief officer** and **member level sponsorship** and engagement is also critical to ensuring that your organisation is aware of and can effectively manage the risks involved in energy procurement appropriately.

## We have decided to change our approach.  What are the next steps?

Firstly, you need to ensure you have **delegated authority** in order for a PBO to make purchasing decisions on your behalf, in line with the risk management strategy you have agreed with them. This may involve changing your Contract Standing Orders and/or Financial Regulations.

Secondly, you need to gather site and property data to enable any transfers to new providers. The sorts of information you should be able to provide can be found in the LCE Energy Procurement Action Plan, at www.lcpe.gov.uk/energy.

For more information and support contact the LCE Energy dedicated Change Manager on 020 8489 1102 or email lce.energy@haringey.gov.uk.