

COST CONTROL, RISK, SAVINGS IN ENERGY

To be read in conjunction with - Decision making in energy procurement

What impact does energy procurement have on my organisation?

Across London, local authority's gas and electricity expenditure is approximately £300 million per year. By procuring energy supplies from a public sector buying organisation offering aggregated, flexible risk managed contracts, up to £30 million of this cost could be avoided.

You will be aware that the increasing volatility of the energy markets continues to present challenges to budgets and without very careful management, essential front-line services could suffer. Gas and electric contracts that were let in October 2007 and due for renewal in October 2008 are likely to see price increases of up to 100%.

At the same time there is downward pressure with continuous expectations to deliver better value for money. Settlements are being reduced, particularly in the South East, CSR 07 presents clear and challenging efficiency targets and no doubt further efficiency gains will be expected in CSR 10.

What should senior management do to ensure efficient use of resources?

In response to the Transforming Government Procurement initiative announced by the Treasury in 2007, the OGC launched the pan government energy project in April 2007. The project has developed a series of recommendations and has recently announced clear guidance that all public sector organisations should adopt best practice in gas and electricity procurement and buy energy through public sector buying organisations offering approved flexible, risk managed, aggregated contracts.

As a chief officer with finance responsibilities, it is recommended that you find out:

- Where within the organisation your energy procurement, management and billing administration functions sit.
- Which organisation is being used to buy energy on your behalf and determine whether it is an aggregated, flexible risk managed contract.

And

- Whether sufficient liaison and information sharing takes place to effectively buy and reduce demand for energy and gear up for carbon reduction commitments.
- Provide support to ensure any necessary changes can be made.

What are the benefits?

In terms of achieving and providing evidence of value for money and efficiency gains¹, flexible, risk managed, aggregated contracts are recommended by the pan government energy project

¹ It is important to note efficiency and savings figures will no longer be based on the difference of annual contract prices against previous years, but instead defined as procurement performance against market average wholesale commodity prices.

for use by the public sector. The London Centre of Excellence (LCE) Energy Project has built upon best practice and in consultation with London customers and market specialists have defined customer service expectations in a Specification of Requirements (attached).

The major benefits include:

- Aggregated volumes which reduce supplier margins and tendering costs.
- Access to wholesale markets (including multiple purchasing opportunities) and to minimise price risk use robust risk managed strategies with observed governance procedures.
- Transparent pricing mechanisms.
- Access to future options, such as buying directly from generators, which will reduce long term price risk & increase security of supply including the use of new renewable sources.
- Continuous improvements to customer service and the development of value added services.
- Commitment to work with the London Energy Project and share best practice.

OGC approved draft methodologies for savings demonstrate that simply by switching from a traditional fixed contract to an aggregated, flexible risk managed contract² costs can be controlled by up to 10%, i.e. £1 million can be avoided on £10 million pounds energy expenditure.

The benefits (up to 10%) explained

- Evidence shows that when electing to take a fixed price contract, a risk margin is applied to cover any price fluctuation during that day's trading, which is not applied to real-time trades on the wholesale market. Prices achieved are closer to bid prices rather than offer prices, which are more often achieved in fixed contracts.
- Aggregated contracts (typically at least 10 typical authorities) bring added value as not only will utility suppliers reduce their cost to serve, they will also provide improved and dedicated customer service, which mean registrations, billing queries and other administrative problems are dealt with more promptly and efficiently and energy staff are freed up to manage energy demand, rather than querying bills.
- Aggregated contracts reduce residual volumes providing further savings.
 - These combined with other benefits, such as avoiding tendering costs, market intelligence, TPI costs and shifting the market will lead to ~ 5% savings.
- Additionally, over the past three years flexible versus fixed price contracts have delivered 5.2% cost reduction against wholesale market average.

What are my organisation's options?

London public sector bodies should review contracts due for renewal within the next 12 months, and start enabling processes, such as securing Member approval for delegated authority, ensuring accuracy of site consumption and property data to transfer to new approved contracts and/or service providers.

² It should be noted that past performance is not a guide to future performance, thus the saving from flexible procurement will vary

Capital Ambition through the work of the LCE Energy project and in collaboration with the Pan Government Energy Strategy Team has evaluated the contracts currently available and recommends all London public sector organisations to move onto the new approved arrangements at contract renewal.

Three professional buying organisations (PBO) have been rigorously evaluated by an independent customer panel against the specification. The LCE is pleased to confirm that following evaluation two PBOs, Laser³ and OGC Buying.Solutions, which offer pan government energy project approved flexible⁴ risk managed contracts, have sufficiently satisfied the Specification of Requirement. The third PBO, The Energy Consortium (TEC), is working towards developing a new additional product for the public sector that will meet pan government energy projects and LCE requirements in the near future.

A value added outcome of the new contract arrangements is that London public sector bodies will benefit from the greater scrutiny and challenge that this collaborative project has brought about and the commitment to continuous improvement expressed by the participating PBOs.

What should my organisation do now?

A London council with gas or electricity contract renewals should now make the necessary arrangements to use one of the following contracts:

- Laser's flexible gas and electricity contracts only.
- Buying Solutions gas and electricity contracts.

Both organisations offer a range of risk management options, and your selection will be dependent on your organisation's appetite for risk and need for cost certainty.

My organisation may need further support

We hope that the forthcoming publications, workshops and factsheets provide you with sufficient information to make changes to your energy procurement practices. Additionally, to support this process Amanda de Swarte, the LCE Project Change Manager will be available to support London public sector bodies at both a strategic and practical level.

Should you have any questions or require further information, please do not hesitate to contact the LCE Energy Project office at Haringey Council on 020 8489 1102 or by emailing lce.energy@haringey.gov.uk.

You may also find further general information at: <http://www.lcpe.gov.uk/Energy/Default.asp> or information specific to the workshop held on the 12th September at: http://www.lcpe.gov.uk/Energy/Energy_Procurement_Workshop_September_2008.asp

³ Please note that LASER **flexible** contracts are approved by the pan government energy project and recommended by LCE but **fixed** price contracts are not approved by Treasury nor recommended by LCE.

⁴ Definition of flexible contract – a contract with the ability to fix volumes over a series of purchases in the wholesale market