

Regional Improvement and Efficiency Partnerships

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Regional Improvement and
Efficiency Partnerships



Local Government Association



improvement and development agency

2 Members' Guide ✓

Top tips for making savings through better procurement in energy

As local government finances are squeezed during difficult economic times, it will become even more important for councils to work together to save money and keep council tax down. This series of member guides provides tips on how your authority can make savings through better procurement.

Making savings on Energy

Did you know?

Councils spend £1.4bn each year on electricity and gas, accounting for 3% of the UK energy market. By smarter collaborative procurement and better risk management, they could save up to 10%, or £140m each year. Read on to find out how your council could benefit.

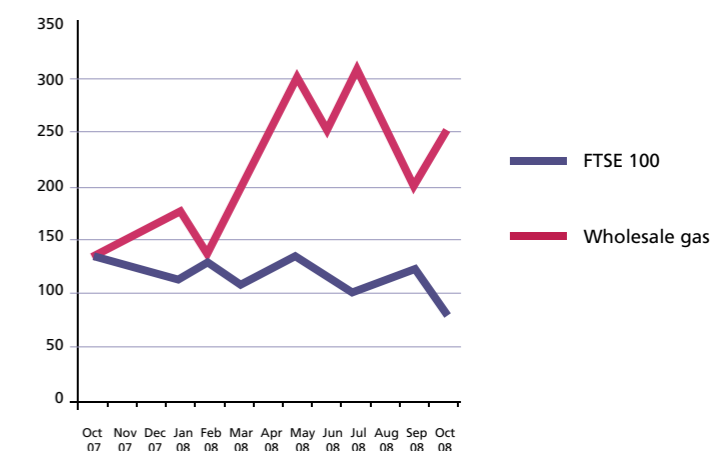
What does 'energy' comprise of?

For most councils, electricity and gas offer the biggest opportunity for cost reduction. They are the focus of this guide. But there are also big savings to be made in the purchase of liquid fuel, and by improving energy bill validation processes and the energy efficiency of buildings. **Implementing sustainable policies and efficiency projects will typically avoid a further 10% costs on top of those discussed here.**

Why should it matter to members?

Energy market specialists believe that **many councils could save up to 10%** on their electricity and gas bills. When you consider that a typical county council spends £10 -15m each year on

electricity and gas, and a large London borough up to £10m, that means savings of between £1m and £1.5m. **Across local government as a whole, up to £140m could be saved.** (If your council is already applying recommended best practice, it may already be accessing these savings).



Buying electricity and gas for a council is nothing like buying for the home. Suppliers do not pass on to domestic customers the effects of short term volatility in wholesale markets. But this is not true for councils who buy on the commercial market **where prices can move + or – 20% within a month and major changes can occur even within a single day.** This means that if the market is moving upwards, a contract costing £10 million on the first day of the month could cost £12 million by the end of the month. The energy market is even more volatile than the stock market and uses many of the same complex financial instruments as the financial services industry. **40% of all councils buy their electricity and gas on a fixed price basis, usually through an annual tender. If the council fixes its price at the wrong time, it can be a very expensive mistake.** Energy procurement requires professional risk management skills, a thorough working knowledge of the energy sector and trends, and a continuous analysis of the market. It is a specialist area and, just as members would keep a



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Local Government Association

The Local Government Association is the national voice for more than 400 local authorities in England and Wales. The LGA group comprises the LGA and five partner organisations which work together to support, promote and improve local government.

I&DeA LACORS LGE Local Partnerships

watchful eye on the council's investment and pension funds to ensure they are appropriately managed, the same should apply to energy. Controlling costs and managing budgets are critical, and the adoption of **flexible purchasing** means that councils can manage the risk of getting locked in to high fixed price contracts.

Of the £1.4 billion councils spend each year on procurement of electricity and gas, experts believe that an average of 5% cost reduction can be achieved by better procurement, and a further 3.5% from aggregating volumes (therefore reducing supplier margins) and buying flexibly (therefore avoiding certain costs).

They recommend that **councils should buy their energy through an aggregated, flexible risk managed framework managed by energy specialists at a Central Purchasing Body (CPB)** and that they put in place, alongside better procurement, a programme to reduce energy consumption across their estate.

What are the problems and opportunities?

1 Members at a large county council were increasingly concerned at the spiralling cost of electricity. After looking into it, they found that the council, whilst proficient in the procurement of many commodity goods and services, was buying its electricity under an uncompetitive fixed price annual tender arrangement which had no flexibility. A new contract was negotiated with a major local authority CPB that resulted in a 27% reduction in cost in the first year, rising to 29% in the second year.

2 A borough council recognised that its energy costs were uncompetitive. It lacked in-house expertise and, whilst it had recently committed to renewable energy targets, was concerned about the possible higher cost. It wanted to ensure its procurement was compliant with complex EU legislation and knew that the quality of its energy data collection and management was poor, which could result in poor prices from suppliers. It recognised that it needed expert professional help but did not want to pay private broker fees. By using a CPB, it saved 15% on its current costs, met its renewable energy targets, reduced its in-house resource allocation for energy buying and secured a value for money solution for the council and tax payers.

What is the Member's role?

The member's role is to ask the fundamental questions about the way in which energy is currently procured and whether proper risk management is in place:

'who is responsible for purchasing our electricity and gas?'

* decision making on the procurement of electricity and gas should be devolved to specialists, and should not be a political decision. Delegated Authority may be required in Contract Standing Orders and Financial Regulations

'if we use a private broker, what fees and commissions do we pay them, and how is our energy bought?'

* many councils use private brokers whose fees may not be visible to the council, but members should ensure all that all fees and commissions paid by the utility supplier to the broker are declared.

'are we using the services of a specialist energy procurement team at one of the CPBs? If not, why not?'

Depending on the answers to these questions, it may be appropriate for members to *scrutinise* further the procurement and risk management process, get at the facts, and follow up. Apart from the formal process of overview and scrutiny, the Leader and Cabinet may wish to make this an area for particular focus and speak to their Regional Improvement and Efficiency Partnership (RIEP) or the Office of Government Commerce (OGC) for impartial advice.



What is best practice

Members should ask three questions to find out whether the council is adopting best practice in energy procurement:

Are we buying flexibly?

When a council purchases on a fixed price basis, officers typically secure an annual (or longer) price which is kept open for a period of time (say 24 hours) whilst a decision is made, often by directors and/or members. The supplier charges a premium for this period to cover the risk of wholesale prices moving. Flexible pricing allows the annual price to be fixed over a number of trades in the wholesale market over a specified period. This makes the costs more transparent and gives the buyer better control, by allowing the adoption of a risk management strategy.

Are we combining our energy purchasing with others to give a volume that will secure a discount from the supplier?

Larger portfolios are more attractive to suppliers and can attract up to 3% lower prices.

Is our purchasing being conducted in accordance with a well defined risk management strategy?

This means using experts with a thorough knowledge of the energy markets and an understanding of the council's need for budget certainty, who can effectively manage the energy price risk on your behalf.

If the answer to these questions is 'NO':

- **get your scrutiny committee to investigate, and**
- **contact your Regional Improvement and Efficiency Partnership (RIEP) to find out what expert energy procurement expertise is available.**

Checklist

Questions members can ask to assess the capacity of their authority to procure energy professionally and efficiently

Are we using a Central Purchasing Body?

- ✓ **Avoid using part-time non-specialist buyers** - improve effectiveness via a CPB.
- ✓ **Avoid poorly informed buying decisions** which cost councils a significant amount of money.
- ✓ **Access skills and knowledge:** Timing is everything due to the volatility of electricity and gas markets. A CPB has the expertise and resources to constantly monitor the markets and the factors which influence prices, and can manage the buying process on your behalf.
- ✓ **Avoid information overload:** the complex markets generate huge amounts of information which can be used by suppliers to confuse non-specialist buyers.
- ✓ **Use specialist support systems and software.**
- ✓ **Leverage the combined buying power of the public sector** to gain the same benefits as large industrial users, who use variable price contracts to get best prices for large volumes at relatively few sites.

Are we buying flexibly?

- ✓ Flexible purchasing allows the adoption of a **risk management strategy to control costs**.
- ✓ By buying flexibly the council is not **reliant on the supplier's view of the market**.
- ✓ All costs that make up the delivered price of energy are **fully transparent**.
- ✓ **Purchasing in real time removes some costs** – there is no additional premium for keeping a price open to cover the risk of wholesale price movement whilst a decision is made.

In summary, are we adopting best practice?

- ✓ Access to wholesale markets - requires minimum volumes for frameworks.
- ✓ Robust governance and risk management (including multiple purchasing opportunities).
- ✓ Transparent pricing.
- ✓ Access to future options.