

**Forward Plan reference number: FP/096/07/21**

<b>Report title:</b> Procurement of new energy supply contracts and adoption of renewable electricity policy for 2021-202	
<b>Report to:</b> Cabinet	
<b>Report author:</b> Councillor Christopher Whitbread, Cabinet Member for Finance, Resources and Corporate Affairs	
<b>Date:</b> 21 December 2021	<b>For:</b> Decision
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<b>County Divisions affected:</b> All Essex	

## 1. Everyone's Essex

- 1.1. Everyone's Essex sets out the Council's four strategic aims and 20 commitments. The strategic aim of High Quality Environment includes a commitment to Net Zero to work across the Council and County to hit our net zero targets by ensuring that the Council significantly reduces its carbon footprint whilst also supporting an acceleration in the progress towards sustainable energy.
- 1.2. Consistent with achieving this commitment, this paper seeks approval for a new Renewable Electricity Policy for the period 2021 to 2025 and the procurement of new energy supply contracts for electricity and gas from 1 October 2022.

## 2. Recommendations

- 2.1. Agree to procure flexible supply contracts for electricity and gas for the Council's energy requirements for its core estate and infrastructure from 1 October 2022 using an open single stage procurement procedure. Contracts will be for a 3-year contract term with an option to extend for up to 3 years.
- 2.2. Agree that the purchases under the flexible supply contracts over the 3 year term will have a maximum total expenditure of £25.6m (£23.1m for electricity and £2.5m for gas) based on forecast spend in 2022/23 of £8.4m (£7.6m for electricity and £800,000 for gas).
- 2.3. Agree to back up the flexible electricity supply contracts with the purchase of Renewable Energy Guarantee of Origin certificates from the successful electricity supplier at an additional estimated cost of £78,000 per annum.
- 2.4. Agree that the flexible supply contracts will be procured using an evaluation model based on 60% price and 40% quality, of which 5% of the quality score will assess social value.

- 2.5. Agree that the Executive Director, Economy, Investment and Public Health, is authorised to agree the detailed evaluation model for the procurement of the flexible supply contracts in consultation with the S151 Officer.
- 2.6. Agree that the Cabinet Member for Finance, Resources and Corporate Affairs is authorised to award the contracts to the successful bidders following completion of the procurement process.
- 2.7. Agree to adopt the Renewable Electricity Policy 2021-25 in the form appended to this report.

### **3. Background and Proposal**

- 3.1. The Council is responsible for procuring energy for its core estate and infrastructure – this includes circa 250 operational buildings (including offices, libraries, children's centres, youth and respite centres, country parks), highways, street lighting and other infrastructure. The number of operational buildings is expected to reduce as the estate commercialisation programme for core properties progresses. The Council also currently procures energy on behalf of schools including 120 schools for electricity and 80 schools for gas.
- 3.2. The Council currently buys its electricity from Npower Commercial Gas Limited (Npower) and its gas supply from Scottish and Southern Energy Gas (SSE) under flexible supply contracts.
- 3.3. The contracts with Npower and SSE were procured in 2018 for 3 years with an option to extend for a year. Both contracts were extended for 12 months and will expire on 30 September 2022. New supply contracts for electricity and gas are now needed to provide the Councils' energy requirements from 1 October 2022.
- 3.4. Flexible supply contracts were recommended in 2018 – such contracts enable the Council to lock in prices and volumes at any point during the contract term for all or part of the length of the contract instead of committing to a fixed price energy deal which requires prices and volumes to be locked in for the entire length of the contract at a set price from the outset. The alternative contractual arrangement, a fixed cost contract, provides cost certainty but does not allow for potential savings by obtaining the best prices in the market at any given point in time due to fluctuations in the energy market. Recent record wholesale electricity and gas prices highlight how the Council has been protected from price increases under the flexible supply contract and the risk of entering a fixed price contract when market prices are high.
- 3.5. A flexible cost contract makes it easier to allow for changes in volume requirements not forecast at the start of the contract. The Covid pandemic has highlighted how the Council has been protected from unforeseen changes in the Council's energy demand under the flexible supply contract which has enabled us to adjust our forecast and amend purchases accordingly whereas this could not have been possible had the Council been on a fixed supply contract.

- 3.6. Following a procurement exercise, the Council appointed MITIE Facilities Services Limited (Mitie) under a facilities management contract to advise the Council on various matters including providing technical advice and services in relation to the procurement of energy. The contract with Mitie expires in September 2026. Mitie advises the Council when to make purchases of either electricity or gas under the current flexible supply contract. This is managed under an agreed Risk Management Policy and Procedure that ensures appropriate arrangements exist to measure and control risk whilst seeking to obtain the best price possible for electricity and gas over the life of the contracts.
- 3.7. Each purchase of energy is subject to the Council's governance process before Mitie can proceed with the purchase on behalf of the Council. The Council then pays the agreed price for the agreed period.
- 3.8. The energy that the Council has used will emit an estimated 84,590 tonnes of carbon over the life of the current three year contracts for electricity and gas (an average of 28,196 tonnes per annum) split c.60% from electricity usage and c.40% from gas usage. As part of the Council's strategy to reduce its carbon footprint, the Council purchased Renewable Energy Guarantees of Origin (REGOs) from Npower in December 2020. These REGOs show that an amount of renewable electricity equivalent to the amount purchased by the Council (which could come from fossil fuel as well as renewable sources) has been generated from renewable sources and supplied to the national grid. The REGOs also expire on 30 September 2022.

### **Procurement of Electricity and Gas Supply contracts**

- 3.9. The current forecast spend for 2022/23 is £8.4m for electricity and gas. The forecast spend is allocated as set out below:
  - Electricity £7.6m
  - Gas - £800,000

Within these figures the anticipated spend is

- core Council estate £4.1m (£3.3m on electricity and £800,000 on gas)
- highways including Street Lighting is £4.3m on electricity.

These figures include the commodity costs - the cost of the energy itself including production, supply and supplier's margin - and the non-commodity costs which include government levies and taxes, and transportation and distribution charges.

- 3.10. Research has been undertaken with various public sector organisations including district and county councils on their contractual arrangements for energy. The consensus is that they purchase via a national framework agreement such as Crown Commercial Services, Laser or Vertas whereby they benefit from the collective purchasing power, technical support and market expertise as many organisations do not have the capability to approach the market directly.

- 3.11. It is proposed that schools are no longer included in the Council's energy contracts. Maintained schools were asked to confirm by 22 October 2021 whether they wished to continue to purchase energy via the Council's contract in order for the Council to assess the viability of continuing to include such schools. While sixty-six primary schools expressed an interest in being part of the new contract, the level of opt in is too low in terms of volumes of gas and electricity to be a viable inclusion in the new supply contract and to balance out the contract management costs to the Council. Schools who expressed an interest will be signposted to alternative national frameworks which will potentially provide the schools with greater cost certainty than the Council's proposed arrangements. Furthermore, as part of its ambition to reach net zero by 2030 across the core estate including maintained schools, the Council is also investing in a new team within Infrastructure Delivery who will provide advice to all maintained schools on energy efficiency and retrofit measures and options for procuring certified renewable electricity for the school's supply.
- 3.12. For the procurement of the new energy contracts, it is proposed that:
- 3.12.1. the Council continues to purchase via flexible supply contracts for electricity and gas under which the commodity cost of the electricity and gas which typically is 38% / 56% respectively of the overall energy cost will be set at the time the purchase is made;
  - 3.12.2. the supply contracts are for a 3-year term with an option to extend for up to 3 years - Mitie have advised that flexible contracts are typically awarded for 3 years or longer as sufficient time is needed within the contract to allow for effective delivery of a risk management strategy to review the market and to assess whether the product and supplier are still providing value for money;
  - 3.12.3. there are 2 lots - a single supplier will be awarded a contract for each lot:
    - Lot 1 – Electricity supply including:
      - REGOs to provide electricity 'backed by' renewable energy which is an additional cost; and
      - 'Sleeving Arrangements' under which any renewable electricity sourced from off-site renewable generators can potentially be included at an additional cost in the electricity supply contract should the Council choose to do so at a later date. The supplier will be required to provide this option.
    - Lot 2 – Gas supply;
  - 3.12.4. the lots are procured using an open single stage procurement procedure - there are a small number of suppliers in this market and the Council would benefit from evaluating the benefits of all bidders;
  - 3.12.5. tenders will be evaluated on the basis of 60% price and 40% quality, of which 5% will assess social value;

- 3.12.6. tenders will evaluate suppliers' charges and non-commodity costs which include:
- suppliers' operating cost and profit margin - this typically covers 1.4% / 0.9% of the overall cost of electricity / gas respectively; and
  - other non-commodity third party charges which include network costs and social and environmental obligations and taxes – this makes up the remaining 61% / 43% of the overall cost of electricity / gas respectively;
- 3.12.7. Mitie provides technical advice, support and services on the procurement and tender documents and purchasing the energy under the new contracts in accordance with the terms of its existing contract with the Council;
- 3.12.8. Quality questions will cover topics including:
- Customer management services including service commitments on prompt and accurate billing, electronic invoicing and wider account administration and customer service standards for core estate
  - Allowance for reforecasting of forecast volumes
  - Sustainability and environmental criteria such as adherence to Sustainable Development Goals
  - Escalation process within the organisation
  - Flexibility in customer portfolio with ability to add and remove sites
  - Provision of management information data e.g. price, consumption, and other site data as a source of management information for the Council
  - Allowing for sleeving in renewable electricity from a third-party renewable generator .
- 3.13. It is proposed that the tender will be published in January 2022, and suppliers will be given 30 days to respond. Mitie and the Council will jointly evaluate tenders based on the evaluation criteria published within the tender documents. Award and completion of contract is anticipated to take place in May 2022 following which purchases of energy for the period from 1 October 2022 onwards can start.

### **Renewable Electricity Policy**

- 3.14. A commitment in Everyone's Essex is to "work across the Council and the County to hit our net zero targets, by ensuring that the Council significantly reduces its carbon footprint whilst also supporting an acceleration in the progress towards sustainable [...] energy...".
- 3.15. The Council also has an ambition to achieve a net zero carbon core estate and local authority maintained schools estate by 2030 through investment in energy efficiency, retrofit measures and increasing the use of renewable electricity in the estate. Furthermore, the Essex Climate Action Commission recommended that

Essex produces enough renewable energy within the county to meet its own needs by 2040.

- 3.16. In response, the Council should consider where it sources its energy from and how green it is.
- 3.17. The Council does not currently have a consolidated policy for buying renewable electricity for its maintained estate. There is now an opportunity with the new procurement to adopt a policy for buying 'green' electricity.
- 3.18. It is proposed that the Council adopt a Renewable Electricity Policy for 2021-2025 (the Policy), as set out in Appendix 2, to provide a framework for future electricity purchases, that has three priorities:
  - 3.18.1. Maximising opportunities for "on-site" renewable electricity generation through rooftop solar photovoltaics (PV) and other technologies on the Council's core estate;
  - 3.18.2. Using the Council's purchasing power to buy "off-site" renewable electricity direct from renewable energy generators (such as a solar farm) and incentivising additional renewable energy to be built to meet that demand;
  - 3.18.3. Committing the Council to buy the remainder of its electricity requirements from an electricity supply contract that is "backed by" certified renewable energy by purchasing REGOs.
- 3.19. Adopting this Policy will allow the Council to:
  - 3.19.1. support delivery of the commitment to climate action in Everyone's Essex
  - 3.19.2. respond positively to the recommendations of the Climate Commission for Essex;
  - 3.19.3. support the Council's ambition to reach net zero in its core estate by 2030;
  - 3.19.4. support the development of a low carbon economy in Essex - leading by example and encouraging businesses to invest in renewable energy;
  - 3.19.5. support the national net-zero 2050 target.
- 3.20. Each priority on its own has benefits and limitations:
  - 3.20.1. On-site renewable generation (solar PV) benefits from avoiding the cost of having to supply electricity through the grid. The limitation is that only approximately 10% of the Council's electricity can be supplied through this route due to limitations in available space for solar PV roof systems.

- 3.20.2. Off-site renewable generation provides multiple benefits such as a long term hedge on energy prices, cost certainty, direct access to renewable energy and using the Council's purchasing power to incentivise more renewable generation to be built. The disadvantage is that it requires a long term commitment and can be a more complex arrangement that takes time to negotiate.
- 3.20.3. Certified renewable energy can be put in place quickly but does not mean that the Council is purchasing renewable energy, rather it enables the Council to state that an amount of renewable electricity has been generated on the UK grid equivalent to the amount of electricity that the Council has used.
- 3.21. The three priorities together aim to provide the combined benefits of energy resilience, carbon reduction, reputational benefits, cost certainty and the opportunity to make long term savings on energy commodity costs.
- 3.22. Whilst this Policy addresses renewable electricity, options for buying renewable gas are limited. It is difficult to procure in the volume the Council would need due to limited generation in the UK and renewable gas (bio-methane) has an estimated price premium of c.17% -25%. On this basis the Council will not specify a renewable gas contract in the current procurement. The Council will however continue to review the market and will explore opportunities to reduce its use of gas by decarbonising heating systems through converting sites from gas or oil heating to electric heating supplemented by other energy efficiency and retrofit measures.

#### **4. Links to our Strategic Ambitions**

- 4.1. This report links to the following aims in the Essex Vision:
- Develop our County sustainably
- 4.2. The report also supports the strategic aim "High Quality Environment" within the Council's Plan for Essex 2021-25; Everyone's Essex. It supports the commitment to work across the Council and County to hit our net zero targets by ensuring that the Council significantly reduces its carbon footprint whilst also supporting an acceleration in the progress towards sustainable energy.
- 4.3. Approving the recommendations in this report will have the following impact on the Council's ambition to be net carbon neutral by 2030:
- Any increase in on-site generation would have a direct reduction on the Council's carbon emissions
  - Any increase in off-site renewable energy, i.e. the Council buying its energy from a renewable generation site such as a solar farm would enable the Council to state that its carbon emissions for that electricity are nil.

- 4.4. This report links to the following strategic priorities in the emerging Organisational Strategy 'Everyone's Essex':

- A high quality environment

## 5. Options

- 5.1. **Option 1: Do not procure new supply contracts and let the current contracts continue on market rates (not recommended)**

When the current supply contracts expire, the Council would have to remain with the current suppliers to ensure continuity of supply – the energy rates would be the high end of the prevailing rates at that time. This could see an estimated increase in billed rates for commodity costs of 200% - 300% and this would not be value for money for the Council.

- 5.2. **Option 2: Procure fixed price fixed term supply contracts (not recommended)**

This would provide the Council with budget certainty for the full duration of the contract for both commodity and non-commodity costs. Fixed price contracts are also simpler to administer in billing arrangements. The disadvantages are that the Council would lose the ability to buy electricity or gas at more competitive market rates which can be beneficial compared to a fixed price. Suppliers will also price risk into a fixed contract which makes fixed price contracts potentially more expensive. There will also be less ability to manage volumes under a fixed contract which could result in penalties if the Council does not use all the electricity it commits to (or if it needs to use more than it contracted to) under a fixed contract. Fixed contracts would also not allow the Council to buy off site renewable energy as recommended in the renewable electricity strategy but REGOs would be available.

- 5.3. **Option 3: Procure flexible supply contract with ability to adjust volumes and adopt the proposed Policy (recommended option)**

The new flexible supply contracts will be subject to the same risks and benefits as the current supply contracts. Purchases of energy will be made via a trading desk provided by Mitie who will advise on future purchases to assist the Council to make multiple energy purchases taking advantage of the benefits of price changes in the commodity market during the life of the contract. This is a strategy of buying "little and often" that enables the spread of risk over several purchases ideally resulting in an overall lower energy price. It also enables the Council to pursue the strategy for renewable energy and sourcing from off-site renewables which would not be available under a fixed price contract.

Flexible contracts also provide other benefits including:

- options for fixing non-commodity costs



- allowing volumes to be reforecast enabling the Council to allow for changes in its demand profile from, for example, estate rationalisation
- provide more flexibility when adding additional sites to the contract (i.e. taking advantage of already purchased commodity).

The approval of the proposed Policy will provide a framework for future energy purchases that is consistent with, and seeks to prioritise, on and off site renewable electricity generation. It also commits the Council to buy the remainder of its electricity requirements from an electricity supply contract that is “backed by” certified renewable energy by purchasing REGOs. There is a charge for buying these certificates. The priorities set out in the Policy will assist the Council in reducing its carbon footprint.

#### **5.4. Option 4: Flexible Agreement with a Cashout mechanism (not recommended)**

This is similar to option 3 but all volume imbalance risk would sit with the Council. The customer buys to a forecasted volume, however any deviation (either +/-) is ‘cashed out’ to an agreed index price. These contracts offer complete freedom to purchase but are risky to manage if not understood, or forecasting is not carefully considered. Index prices can be very volatile and as such can significantly affect the contract prices on a month by month basis. This option includes very high price risk for the Council and is therefore not recommended.

## **6. Issues for consideration**

### **6.1. Financial implications**

#### **The energy contracts**

- 6.1.1. The Council requires energy to operate its core estate and infrastructure and this is an unavoidable cost, although price and volume are variables in determining the actual total cost incurred. Consequently the Council has already made budget provision for the energy contracts within its base budget and that provision is updated on an annual basis based on updated prices and volumes.
- 6.1.2. The net annual energy budget included in the MTRS across the Council estate (including streetlighting) totals £8.2m based upon draft budget costs for 2022/23. The forecast contract costs are anticipated at £8.4m leaving a small shortfall of circa £200,000. This will be contained within the existing service budget. The price of energy can be split into commodity (the actual energy itself) and non-commodity (e.g. network charges and government tariffs). Both are charged per unit of consumption.
- 6.1.3. In principle the Council’s energy cost incurred will be its consumption multiplied by its contract price. In the flex options the price is not fixed at the start of the contract but is dependent on the energy market with respect to supply and demand and the point at which purchases are made. This contrasts with the fixed price options of agreeing in advance the price to be paid for any given volume

consumption. In both options the market price of energy is one component of the commodity cost. In a fixed price agreement any utility company would factor in risk in its pricing in order to allow for unforeseen future market price movements. To mitigate some of the risks of a flexible contract, at any point within the contract the Council is able to fix our purchasing basket for a predetermined length should circumstances require this.

- 6.1.4. The recommendations include buying Renewable Energy Guarantee of Origin (REGO) as part of the supply contract – this is an avoidable cost of an estimated £78,000 per annum. This estimated cost is conservative and reflects a recent step change in REGO prices quoted by utility companies due to growth in demand for green certificates from corporate energy customers. Whilst the benefits of REGOs are outlined in this report, they come at a cost and their acquisition is over and above the minimum required.
- 6.1.5. Non-commodity charges represent some 65% of the total cost incurred and are generally pass through costs with little ability to manage them. It is possible to fix the price inclusive of non-commodity but again utility companies would factor in risk pricing where none of the parties could control all those non commodity components. Indeed it is possible that utility companies would seek to renegotiate and pass on any increase in non-commodity charges in the event of unforeseen policy or regulatory changes.
- 6.1.6. There is no definitive route to the least cost option for energy. The ultimate cost incurred will be a combination of a perceived forward market price for a fixed price arrangement with risk factored in versus the actual market price under a flex arrangement.

### **The procurement exercise**

- 6.1.7. The proposed procurement approach is considered likely to deliver best value in overall cost terms. This is the most effective route to market, with the flexibility to take advantage of the best market pricing at a given point in time, and also be the most efficient and economical way to procure energy.
- 6.1.8. The total consultancy costs for the Council to procure contracts over the proposed contract term, is a maximum one off cost of £32,350 plus an annual cost of £48,575. This will be delivered through Mitie Energy, as part of the overall Mitie FM contract. The total Year 1 cost is £89,925 or £80,925 excluding the contingency. There is budget provision to cover Mitie's fees over the 3 years of the contract, however there is an immaterial shortfall in 2022/23 which we will seek to mitigate from within existing budgets. The Year 1 cost is broken down as follows:

<b>Service</b>	<b>One Off Consultancy Fee</b>
Procurement Flex (Electricity (HH, NHH and UMS) and Gas)	£32,350
Contingency fund	£9,000 - (only to be used if the process becomes more complex than

	anticipated) - as of 29/10/2021 this has not been used.
<b>Service</b>	<b>Per Annum Cost</b>
Risk Management Service – Electricity and Gas (Outsourced)	£48,575

6.1.9. Provision of the Council's costs will be made from the current budget for the Mitie contract within Property. The cost of managing the Bureau service is already part of the main Mitie FM contract. The Risk Management Service is an additional charge at £48,575 which was added to the main Mitie FM contract in 2018.

6.1.10 The likely costs of the contract management have been favourably benchmarked against a neighbouring Authority.

## 6.2. Legal implications

6.2.1. The Council is obliged to obtain the best value energy costs to operate its core estate and infrastructure, but it is permitted to specify green energy if it considers it appropriate.

6.2.2. The proposed energy supplies will be subject to the full regime of the Public Contracts Regulations 2015 (the Regulations) and the proposed procurement would be compliant with the Regulations.

6.2.3. Any social value considerations should be relevant and proportionate to the contract and only relate to the metrics set out in the Public Services (Social Value) Act 2012. Contracts should be awarded on the basis of the most economically advantageous tender and qualitative, environmental and/or social aspects should be linked to the subject matter of the contract.

6.2.4. It is noted that Mitie will provide the Council with advice on its purchases of energy under the proposed flexible supply contracts. Mitie provides such services under the current FM contract which was compliantly procured. All purchases of energy will be subject to separate governance at the time of such purchases.

## 7. Equality and Diversity implications

7.1. The Public Sector Equality Duty applies to the Council when it makes decisions. The duty requires us to have regard to the need to:

- (a) Eliminate unlawful discrimination, harassment and victimisation and other behaviour prohibited by the Act. In summary, the Act makes discrimination etc. on the grounds of a protected characteristic unlawful.
- (b) Advance equality of opportunity between people who share a protected characteristic and those who do not.
- (c) Foster good relations between people who share a protected characteristic and those who do not including tackling prejudice and promoting understanding.

- 7.2. The protected characteristics are age, disability, gender reassignment, pregnancy and maternity, marriage and civil partnership, race, religion or belief, gender, and sexual orientation. The Act states that 'marriage and civil partnership' is not a relevant protected characteristic for (b) or (c) although it is relevant for (a).
- 7.3. The equality impact assessment indicates that the proposals in this report will not have a disproportionately adverse impact on any people with a particular characteristic.

## **8. List of appendices**

- 8.1. Appendix 1: Equality Impact Assessment.
- 8.2. Appendix 2: Renewable Electricity Policy 2021-2025

## **9. List of Background Papers**

None declared.